Technology
Will Telepresence Kill the Business Trip?
p52

Real Estate
The Pirates Of Turks And Caicos
p68

Global Economics
The Mystery of Berlusconi's, er, Staying Power
p11

Plus

Obama's Digital Head Fake	p33
Egyptian Military Inc.	p12
Toyota's Dull Corolla	p21
The Economics of Oscar Swag	p80
TiVo for Print	p40

February 21 – February 27, 2011 | businessweek.com

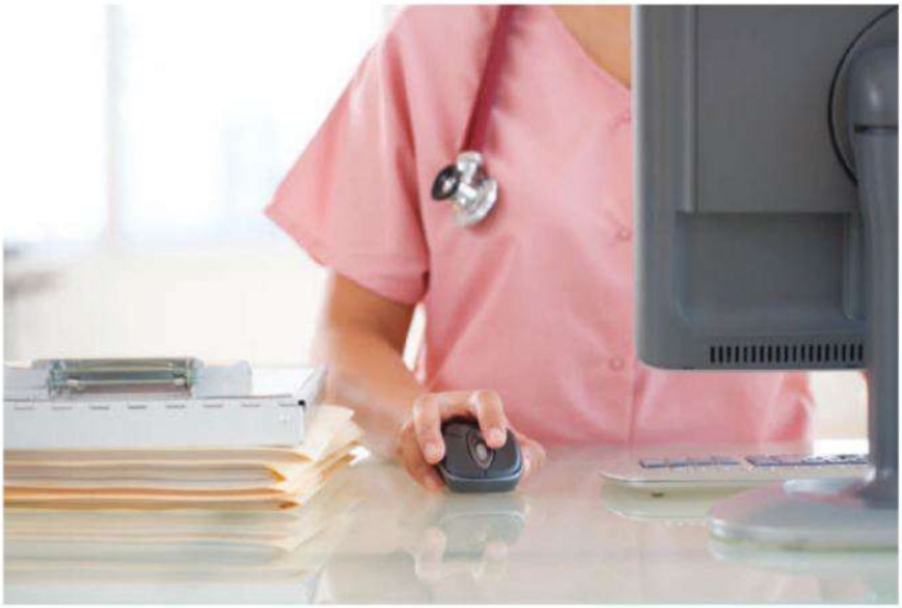
Bloomberg Businessweek

Weather, Speculation, And Politics Have Created A Global Food Crisis That Threatens... Everything

p7



WorldMags



Expansion Team

As a healthcare group grows exponentially, its IT team and NEC work hand in glove.

As the longtime Director of Information Technology for the Mount Kisco Medical Group (MKMG), Joe Abate has one standing goal: Don't ever let IT be the reason something doesn't work. That's a stiff challenge for a group of almost 250 physicians and their support staff who are spread out over more than 30 buildings in Westchester, Putnam and Dutchess Counties in New York. Providing successful technology support for MKMG boils down to real-time access to information from any and all of the group's scattered locations. With more than 100 physicians dedicated to specialties and subspecialties, a remarkable amount of data flows seamlessly throughout MKMG's system, including radiology imagery that is "not typical corporate data like e-mails," says Abate.

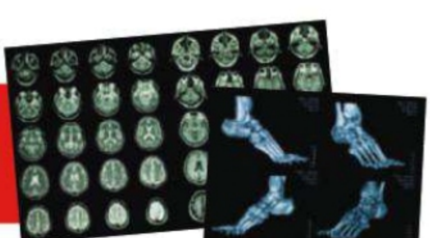
"Our intent is that when users want information they know it's there, and they can focus on the patient experience rather than the nuts and bolts of information flow," says Jeff Williams, the Enterprise Account Manager at NEC who has worked with Abate and his team for more than a decade.

In that time, MKMG has consistently grown, acquiring and consolidating existing practices. Assembling a healthcare group from disparate parts presented Abate and Williams with the challenge of resolving conflicts of standards, all the while staying ahead of the rapid pace of expansion. "NEC is my 'point person' on everything involved in expanding or improving our network," says Abate, who meets with Williams each month to strategize about existing and future projects. "We have a really strong and trusted communication process, and that opens our vision to solutions," says Williams.

Lighting up the dark

The hot topic in recent meetings has been the creation of a new data center in a building in Chappaqua, N.Y., on the site of the former *Reader's Digest* campus. The new center will serve as a backup should the primary data center go offline for any reason, and physicians, staff and patients will have no idea that anything has changed. With Abate acting as quarterback, NEC has been in the room for every meeting regarding the project, consulting and interviewing fiber-optic providers to find a solid match for MKMG's needs. Ultimately, a provider was identified that had nearly all of the necessary unused (or "dark") fiber in place, requiring just a small additional link. MKMG made the one-time investment in equipment that allowed it to "light up" the dark fiber, thus becoming part of a trend of businesses opting for private fiber, which is more efficient and incurs lower monthly costs than renting bandwidth from an existing carrier.

The process of creating the new data center demonstrated how effectively Abate and Williams work as a team. "The first plan we laid out for it was just too expensive," says Abate. "So we circled back and came up with a cost-effective solution." That solution, it turns out, was exactly what Abate was looking for back in 1999 when he deemed his system too inflexible and expensive, and his supplier unhelpful. Desiring a partner rather than a vendor, Abate turned to NEC and Williams, forging a powerful team that always has an eye on what's around the corner. "Network management is not a static thing," says Williams. "Just because something's good enough today doesn't mean it will be going forward." ●



A remarkable amount of data must move seamlessly throughout MKMG's system, including radiology imagery that is "not typical corporate data like e-mails flowing back and forth," says Abate.

TOM GRILL/GETTY IMAGES

WorldMags



A Reliable, Strategic Partnership For Healthcare Providers

Elevate Performance™ with NEC. For more than two decades, NEC has designed, delivered and managed custom IT solutions for Mount Kisco Medical Group. From real-time location services to Unified Clinical Communications, NEC can create powerful custom IT solutions designed to meet your unique business challenges.

Find out more › **www.necelevateperformance.com/healthcare**

© NEC Corporation 2011.
NEC and the NEC logo are registered trademarks of NEC Corporation.
Empowered by Innovation is a trademark of NEC Corporation.

Empowered by Innovation NEC

WorldMags

High yield without high anxiety.

Get real answers about investing in high yield funds.

You want the high yield of non-investment-grade debt. But you also want the issuer diversification, extensive credit analysis, and risk management that only a leader in high yield fund investing can deliver. See what Fidelity's high yield funds can do for your portfolio.

For high yield funds, what's an approach to consider if I feel rates might rise and inflation pick up?

Fidelity® Floating Rate High Income Fund (FFRHX)
This fund invests primarily in floating rate loans, whose coupon rates typically rise as interest rates rise.

What other high yield choices could I consider?

Fidelity® Focused High Income Fund (FHIFX)
Invests the majority of its assets in bonds rated at the top of the non-investment-grade range.

Fidelity® High Income Fund (SPHIX)
Invests broadly across the entire credit-rating spectrum of high yield corporate bonds.

I'm comfortable with the additional risk from seeking capital appreciation along with high yield—where should I look?

Fidelity® Capital & Income Fund (FAGIX)
Fidelity's most opportunistic high yield bond fund option invests across the entire capital structure of companies—from debt securities through equities—emphasizing lower-quality debt securities.

Call now and talk with a Fidelity investment professional.

800.343.3548
Fidelity.com/highincome

Turn here℠
Fidelity INVESTMENTS

Investing involves risk, including risk of loss. Diversification does not ensure a profit or guarantee against loss.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa.) Fixed income securities also carry inflation risk and credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so avoiding losses caused by price volatility by holding them until maturity is not possible. Lower-quality debt securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer.

Floating-rate loans generally are subject to restrictions on resale and they sometimes trade infrequently in the secondary market, and as a result may be more difficult to value, buy, or sell. A floating-rate loan might not be fully collateralized, which may cause the floating-rate loan to decline significantly in value.

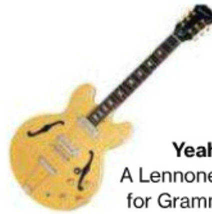
Before investing, consider the fund's investment objectives, risks, charges, and expenses of the fund and its investment options. Contact Fidelity for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.

Fidelity Brokerage Services LLC, Member NYSE, SIPC. © 2011 FMR LLC. All rights reserved. 569315.3.0

WorldMags

February 21 — February 27, 2011
Bloomberg Businessweek

Bloomberg Businessweek Contents



Yeah, yeah, yeah
A Lennonesque guitar: Swag for Grammy nominees p80

Opening Remarks 7

A plunge in the global food supply and rise in prices raise unsettling questions: Can mankind feed itself? Can rich nations forgo profits? And will climate change ever be addressed head-on?

Global Economics 11

How Berlusconi hangs on
Loyal followers, a powerful Finance Minister, and the lack of alternatives may keep him in office

Egypt's army-of-all-trades p12
Tyrants, beware the Swiss p13
A Fed team's hunt for risk p14
Hong Kong's gambling war p16
Tom Keene's EconoChat p16
Charlie Rose talks with Shady El Ghazaly Harb p18



I'm still here
Berlusconi's survival tactics p11

Companies & Industries 21

Corolla in a tight spot
Toyota's compact is the best-selling car ever, but rivals have wow factors it's not close to matching

Asos cozies up to Facebook p22
Indian tycoon Anil Ambani takes a tumble p23
Ryan Kavanaugh builds a 21st century movie studio p24
Speed Dial: Starwood CEO Frits van Paasschen p25
Briefs p26

Politics & Policy 28

So wide the fiscal divide
The sparring over the budget reveals how broad the gulf is between the parties' economic visions

Tea Partiers' cash capers p31
Will Wall Street fill the void as Fannie and Freddie fade? p32
Where Obama's wireless broadband plan falls short p33
Eight states' Medicaid cuts p33

Technology 37

Clash of the platforms
Nokia discards its Symbian system, and the five-way mobile dominance war gets more interesting

Twitter knockoff Sina Weibo is on fire in China p39
Instapaper, a TiVo for words, tries to prop up Old Media p40
As the rest of Asia rolls out 4G, India finally makes it to 3G p42
Innovator: Adam Beguelin's video feed breakthrough p43

Markets & Finance 45

Jitters over a calm market
It's been such smooth sailing that many analysts believe a pullback is inevitable—and healthy

A curious pattern at SAC Capital Advisors p46
The NYSE: A visual history p46
Adjustable-rate mortgages: The fallout may not be so bad p47
Barclays Capital is becoming a powerhouse in M&A p49
Bid & Ask: The week's deals p50



Ruins Construction—and alleged corruption—haunt Turks and Caicos

Features 52

I'll Have My Robots Talk to Your Robots
Telepresence—high-def conference rooms and robots that stand in for remote workers—could make the road warrior obsolete p52

The Operators
Private equity becomes a little less private as megafirm TPG lifts the veil, and makes a $48 billion bet it can beat the market p62

Caribbean Hangover
What happens when easy money builds a playground for the rich and the credit bubble suddenly bursts? p68

Etc. 77

Nothing Tastes as Good as Skinny Feels
As a liquid-only cleanse moves beyond L.A. and New York, Big Juice takes up more of the diet industry

Hollywood Line up for your goodies, Oscar nominees: The swag bag is back p80
Perks Analytics software company SAS has an adjacent country club, a lavish art collection and hotel, free snacks—and no layoffs since its founding in 1976 p82
Next Life Colin Lee segues from accountant to world-class *bel canto* tenor p84
One True Thing A cardigan that any dude's office chair would be proud to wear p85
The Stack *The Asylum* is an up-close look at the rise and fall of the NYMEX oil futures market (and yes, drugs and prostitutes figure prominently) p86
Hard Choices Newark Mayor Cory Booker has had many. Firing cops hurt the most p88

COVER: JUSTIN METZ; WHEAT FIELD: STEPHAN ZIRWES/GALLERY STOCK; THIS PAGE: TURKS AND CAICOS: KEVIN COOLEY; BERLUSCONI: VICTOR SOKOLOWICZ/BLOOMBERG

Index



A B

ABI Research 42, 52
ABN Amro 52
Advanced Micro Devices (AMD) 46
AIG (AIG) 19
Akamai Technologies (AKAM) 46
Albertson, Robert 16
Aletti Gestielle 23
Amazon.com (AMZN) 26
Ambani, Anil 23
Ambani, Mukesh 23
América Móvil 26
American Airlines (AMR) 31, 52
American Tower (AMT) 19
Anybots 52
AOL (AOL) 40, 43
Apple (AAPL) 22, 37, 45
Ashcroft, Lord Michael A. 68
Asos 22
Atheros Comm. (ATHR) 46, 49
AT&T (T) 31
Autodesk (ADSK) 52
AUX Canada 50
Avis Rent A Car System (CAR) 52
Backstage Creations 80
Bain & Co. 62
Bank of America (BAC) 14, 45, 52
Barclays (BCS) 7, 47, 49, 77
Barnes & Noble (BKS) 19
Batista, Eike 50
BBC 68
Beanstalk Group 80
Beguelin, Adam 43
Benishek, Dan 31
Berlusconi, Silvio 11
Bernanke, Ben 14
Beyoncé 77
Bharti Airtel 42
Blackbaud (BLKB) 52
Blackstone (BX) 46, 62
Blinder, Alan 14
BluePrintCleanse 77
Bocom Int. Holdings 39
Bon Jovi, Jon 88
Booker, Cory 88
Borders (BGP) 26
Burger King (BKC) 49, 62

C D

Caesars Entertainment 62
Cameron, James 24
Canada Life 84
Canalys 37
cardigannewyork.com 85
Carlyle Group 26
Carrera 80
Caterpillar (CAT) 31
CBS (CBS) 24, 52
CCMP Capital 62
Chao, Charles 39
Chevron (CVX) 50
CME Group (CME) 86
Christie, Chris 88
Cisco Systems (CSCO) 52
Citigroup (C) 14, 49
Clayton, Dubilier & Rice 50, 62
Clearwire (CLWR) 46
Club Med 68
Cohen, Steven A. 46
Colbert, Stephen 88
Colony Capital 62
Comcast (CMCSA) 31
Condé Nast 68
Cooler Cleanse 77
Credit Suisse (CS) 47
del Missier, Jerry 49
Del Monte Foods (DLM) 49, 62
Delta Air Lines (DAL) 22, 52
Demand Media 40
Deutsche Bank (DB) 7
Deutsche Börse Group 50
DirecTV (DTV) 19
Distinctive Assets 80
Donovan, Shaun 32
Douglas, Michael 68
DreamWorks SKG 23
Duke Energy (DUK) 49

E F G

eBay (EBAY) 22, 46
EchoStar (SATS) 50
Edmunds.com 21
Eleutian 33
Elliott Management 24
Elop, Stephen 37
Emergency Medical Services (EMS) 50
Ernst & Young 84
Evolution Group 16
Facebook 22, 39, 43
FaceTime 52
Fannie Mae (FNMA) 32
FedEx (FDX) 68
Fidelity Investments 26
Ford Motor (F) 21
Foundation Capital 52
FP Turks and Caicos 68
Freddie Mac (FMCC) 32
Fuld, Richard 14
Galleon Group 46
Gap (GPS) 19, 22, 62
Garlick, Helen 68
Gawker 40
GBK Productions 80
Geithner, Timothy 32
General Electric (GE) 46, 50, 52, 62
General Motors (GM) 21
Genzyme (GENZ) 50
Goldman Sachs (GS) 14, 49, 86
Google (GOOG) 24, 26, 37, 46
Gramm, Phil 14
Greenwood Capital Associates 45
Gymboree (GYMB) 62

H I J

Hadid, Zaha 68
Harb, Shady El Ghazaly 18
Hayek, Salma 77
Hearst, Anne 68
Hewlett-Packard (HPQ) 19, 37
Hilton 68
Hiriak, Lynne 85
Hoffman, Mario 68
Home Depot (HD) 19, 26
Honda Motor (HMC) 21
HSBC (HBC) 7
Huawei 42
Huffington Post 40
Hughes Communications (HUGH) 50
Hughes, Martin 32
Hyundai Motor 21
IBM (IBM) 40
Facebook 37
ICICI Bank (IBN) 42
IDC 22
IIFL Securities 42
Inditex 22
Instapaper 40
Intel (INTC) 46
IP Video Market Info 43
iZO Cleanze 77
J.C. Penney (JCP) 22
J. Crew (JCG) 62
JetBlue Airways (JBLU) 68
Jobs, Steve 37
John Lewis 22
Johnson, Ron 31
John Wood Group 50
JPMorgan Chase (JPM) 14, 47
JPMorgan Funds 45

K L M

Karan, Donna 68
Kavanaugh, Ryan 24
Kia Motors 21
KKR (KKR) 49, 62
Kristof, Nicholas 39
Kutcher, Ashton 77
Lakeshore Capital 14
Landgarten, Richard 49
Lee, Colin 84
Lee, Mike 31
Lee, Myung Bak 7
Lehman Brothers 49
Lender Processing Services (LPS) 47
Lions Gate Entertainment (LGF) 24
Lissoni, Piero 68
Lone Star 62
Longreads 40
LPL Financial 62
Maersk 19
Magid Advisors 40
Maher, Bill 88
Mandarin Oriental 68
Marketdata 77
MarketSmith 45
Marriott (MAR) 68
Marvell Technology (MRVL) 46
Mazda Motor 21
McCaul, Michael 31
McConnell, Mitch 28
McCoy, LisaRaye 68
McDonalds (MCD) 68
McGee, Hugh "Skip" 49
McInerney, Jay 68
Mendes, Eva 77
MF Global 23, 49
Michelin 26
Microsoft (MSFT) 31, 37
Mirae Asset Securities 39
Misick, Michael 68
Moelis 49
Moore, Demi 77
Mubarak, Hosni 12, 13
Myspace (NWS) 37

N O P

NBCUniversal 24
NetEase (NTES) 39
Netflix (NFLX) 24
New York Mercantile Exchange (CME) 86
New York Times Co. (NYT) 40
Nobel Biocare 26
Nokia (NOK) 37
Numis Security 22
NYSE Euronext (NYSE) 50
Obama, Barack 28, 33
Ocado 22
Olam International 7
O'Neil Data Systems 45
Opower 52
Organic Avenue 77
Pandora 50
Parker, Paul 49
Parrot Cay 68
Paul, Rand 31
PepsiCo (PEP) 52, 62
Peugeot 52
PNC Financial (PNC) 14
Polaris Consulting 31
Polkomtel 26
Polycom (PLCM) 46, 52
Posternack, Gary 49
Pressed Juicery 77
Procter & Gamble (PG) 52, 62
Progress Energy (PGN) 49
Prudential Financial (PRU) 45
Puma 80

Q R T

Qualcomm (QCOM) 49
Rajaratnam, Raj 46
Read It Later 40
Redwood Trust (RWT) 32
Reed, Tom 31
Reimers Electra Steam 52
Relativity West 24
Reliance Communications 23, 42
Research In Motion (RIMM) 37
RevitaLash 80
Rhapsody 37
Richie, Nicole 77
Ritz-Carlton Hotels 68
Robertson, Nick 22
Royal Dutch Shell (RDS) 52
Rubio, Marco 31
Ryan, Paul 28
SAC Capital Advisors 46
Safeway (SWY) 19
Salt Cay Devco 68
Samsung 80
Sandals 68
Sandler O'Neill 16
Sanford C. Bernstein (AB) 23, 37
Sanofi-Aventis (SNY) 50
SAS 82
Schilling, Bobby 31
Scobey, Margaret 12
Scott, Austin 31
Scott, Tim 31
Sears (SHLD) 19
Simmons, Russell 77
Sina Corp. (SINA) 39
Skype Technologies 52
Slim, Carlos 26
Sohu 39
Sony (SNE) 24
Sotheby's (BID) 50
Southerland, Steve 31
Southern Co. (SO) 31
Spielberg, Steven 23
Starwood Hotels & Resorts Worldwide (HOT) 25
Starz (LSTZA) 24
State Street (SST) 14
Susquehanna Intl. 39

T U V

Talent Resources 80
Tandberg 52
Target (TGT) 19
Tarullo, Daniel 14
Tata Communications 52
Tata Teleservices 42
Tencent 39
Tesco 22
3Leaf Systems 26
3G Capital Management 49
Time Warner (TWX) 24
TiVo (TIVO) 40
Toll Brothers (TOL) 19
Toyota Motors (TM) 21
TPG Capital 62
Tremonti, Giulio 11
Tri-County Telephone Assn. 33
T. Rowe Price (TROW) 26
Twitter 22, 39, 40, 43
TXU Energy 62
United Parcel Service (UPS) 31, 45
Ventana Gold 50
Verizon Communications (VZ) 31, 37
Verizon Wireless 37
Vgo Communications 52
Vitamin Shoppe (VSI) 26
Vodafone Essar 42
Vodafone (VOD) 26, 37
VTB Group 50

W Y Z

Wainhouse Research 52
Walgreen (WAG) 77
Wal-Mart (WMT) 19, 26, 77
Warner Bros. (TWX) 24
Watts, Naomi 77
Wells Fargo (WFC) 14, 32
Wen, Jiabao 7
Wetherell, Gordon 68
Winfrey, Oprah 77, 88
Yahoo! (YHOO) 39
YouTube (GOOG) 24, 37, 43
YouWalkAway.com 47
Zeta-Jones, Catherine 68
ZTE 42
Zynga 26, 37, 52

How to Contact Bloomberg Businessweek

Editorial 212-617-6231 **Sales** 212-617-2900 **Circulation** 800-635-1200
Address 731 Lexington Ave., New York, NY 10022
Email bwreader@bloomberg.net **Fax** 212-617-9065
Customer Service PO Box 8418, Red Oak, IA 51591-1418
Email bwkcustserv@cdsfulfillment.com

Letters to the Editor can be sent by e-mail, fax, or regular mail. They should include address, phone number(s), and e-mail address if available. Connections with the subject of the letter should be disclosed, and we reserve the right to edit for sense, style, and space.

Corrections & Clarifications

"Psst! Wanna Buy a Content Distributor?" (Technology, Feb. 14-20) incorrectly stated that Akamai had lost the Netflix account to Level 3 Communications. Netflix continues to use content distribution services from Akamai as well as Level 3 and Limelight Network.

WorldMags


Now every doctor knows you personally.
IBM helped Servicio Extremeño de Salud offer more personalized care and raise efficiency 30% by sharing patient files in all its clinics. ibm.com/smarterplanet
IBM
IBM, the IBM logo, ibm.com, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2011.
WorldMags
WorldMags

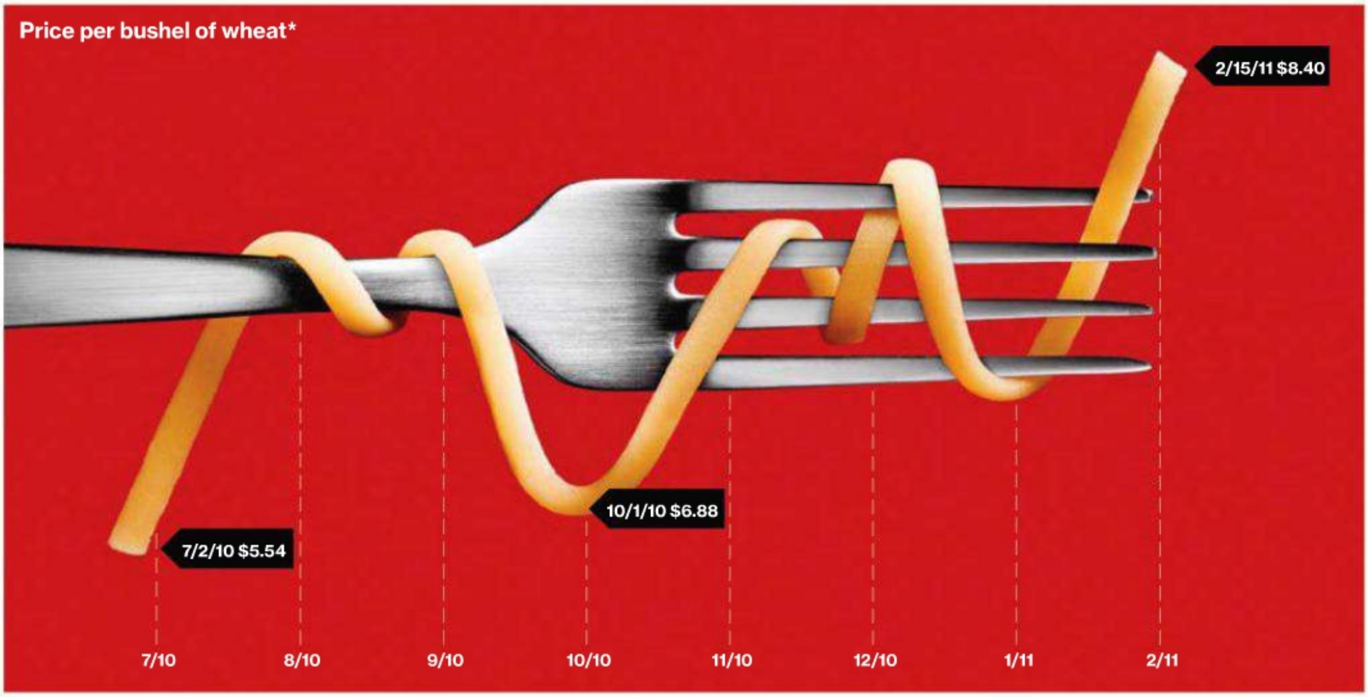


In the United States, insurance coverages are underwritten by individual member companies of Zurich in North America, including Zurich American Insurance Company. Certain coverages are not available in all states. Some coverages may be written on a nonadmitted basis through licensed surplus lines brokers. Prior results do not guarantee a similar outcome. Risk engineering services are provided by Zurich Services Corporation.

WorldMags

WorldMags

Opening Remarks



PHOTOGRAPH BY BARTHOLOMEW COOKE FOR BLOOMBERG BUSINESSWEEK; *ON THE CHICAGO BOARD OF TRADE, FOR CONTRACT NEAREST TO DELIVERY; DATA: BLOOMBERG

Hungry for a Solution

Even if the global agriculture crisis doesn't turn cataclysmic, it represents a massive test

By Eric Pooley and Philip Revzin

As the Tunisian dictator Zine el Abidine Ben Ali discovered in January, there is no surer route to political oblivion than to deny people access to affordable food. On Dec. 17, after Tunisian police assaulted a street vendor named Mohamed Bouazizi and seized his produce cart because, according to his family, he couldn't afford to pay bribes, the 26-year-old Bouazizi doused himself with accelerant and lit a match. He died two weeks later. The riots that ensued–propelled in part by anger over high food prices–drove Ben Ali from power and spread to Egypt, Jordan, Yemen, and Algeria. Ben Ali may be remembered as the despot who was toppled by a vegetable cart.

The hunger that has roiled the Middle East was not caused by the whims of autocrats and cops. It began last year with crippling drought in Russia and later Argentina, and torrential rains in Australia and Canada. The deluges in Saskatchewan were so sustained and intense that farmers couldn't plant some 10 million acres of wheat, according to the Canadian Wheat Board. "What is typically the driest province was never wetter," said the governmental agency Environment Canada. Shrunken wheat harvests in those countries, along with cool, wet summer weather in the American Midwest that delayed the U.S. harvest, helped drive wheat prices at the Chicago Board of Trade up by 74 percent in the past year. Corn traded in Chicago rose by 87 percent during the same period. More recently, grain prices have spiked even higher because of yet another drought, this one threatening China's wheat crop, the world's largest. In that country's eight major wheat-producing provinces, some 42 percent of winter wheat cropland has been hurt by a dry spell, according to Agriculture Minister Han Changfu.

Overall, the U.N. Food and Agriculture Organization in Rome says global food prices surged in January to record levels, based on data reaching back to 1990. "Whenever you get the market as tight as we are now, hoarding becomes widespread," says Abdolreza Abbassian, a senior economist at the FAO. Wheat prices may keep rising until the summer, he predicts, because importers are speeding up purchases to outrun inflation. Prices are more likely to stay high or go higher in the next six months, he adds, than to decline.

Whether the world tips into agricultural mayhem or not depends on the North China Plain's next wheat harvest

Whether the world tips into agricultural catastrophe this year depends on the fate of the wheat on the North China Plain. "You need two perfect harvests through the summer of 2012 to get stockpiles back to an acceptable level," says Jason Lejonvarn, a commodities strategist at Hermes Fund Managers in London. Unless sufficient moisture reaches the parched seedlings, a net exporter of wheat could become a net importer of wheat, further stressing world markets. Short of that, a Chinese ban on wheat exports

WorldMags

WorldMags

would also send prices higher, meaning that global grain shortages—once thought to be a disaster of the past—could return. Even American commodities buyers are feeling the pinch. "There is not one crop you can point to that is without supply problems," says Steve Nicholson, a commodity procurement specialist for International Food Products in St. Louis. "Production is not keeping up with demand."

Even if the worst does not come to pass, this sudden fracture in the global food supply represents a massive test—or, more accurately, a series of them.

At the most basic level, the crisis is a test of mankind's ability to feed itself. Industrial agricultural techniques have boosted crop yields and kept food prices low for decades, but the era of predictable abundance that fueled the world's population growth to almost 7 billion people may be over. Relief agencies, already lashed by hurricanes, earthquakes, volcanic eruptions, and government budget cuts, are ill-equipped to handle severe food shortages. Yet rising global food prices have pushed 44 million more people into extreme poverty in developing countries since June, the World Bank says. "Global food prices threaten tens of millions of poor people around the world," World Bank President Robert Zoellick said in a Feb. 15 conference call. "The price hike is already pushing millions of people into poverty and putting stress on the most vulnerable, who spend more than half of their income on food."

The price escalation is also triggering inflation in the developing world. "In many of these emerging markets, two-thirds of the consumer price index is essentially food, energy, and transportation," New York University economist Nouriel Roubini told Bloomberg News in January. "When these things rise, it becomes a really significant social cost."

The inflationary impact of the crisis is likely to be more subdued in the developed world. While the U.N. estimates that the poorest countries paid as much as 20 percent more for food in 2010 than in 2009, in the U.S., the world's largest food exporter, retail food prices rose just 1.5 percent last year and will gain as little as 2 percent in 2011, according to U.S. Agriculture Dept. estimates. "We are a food-abundant country and the last place where food inflation is going to rise," says Erick Erickson, an economist at the Washington-based U.S. Grains Council.

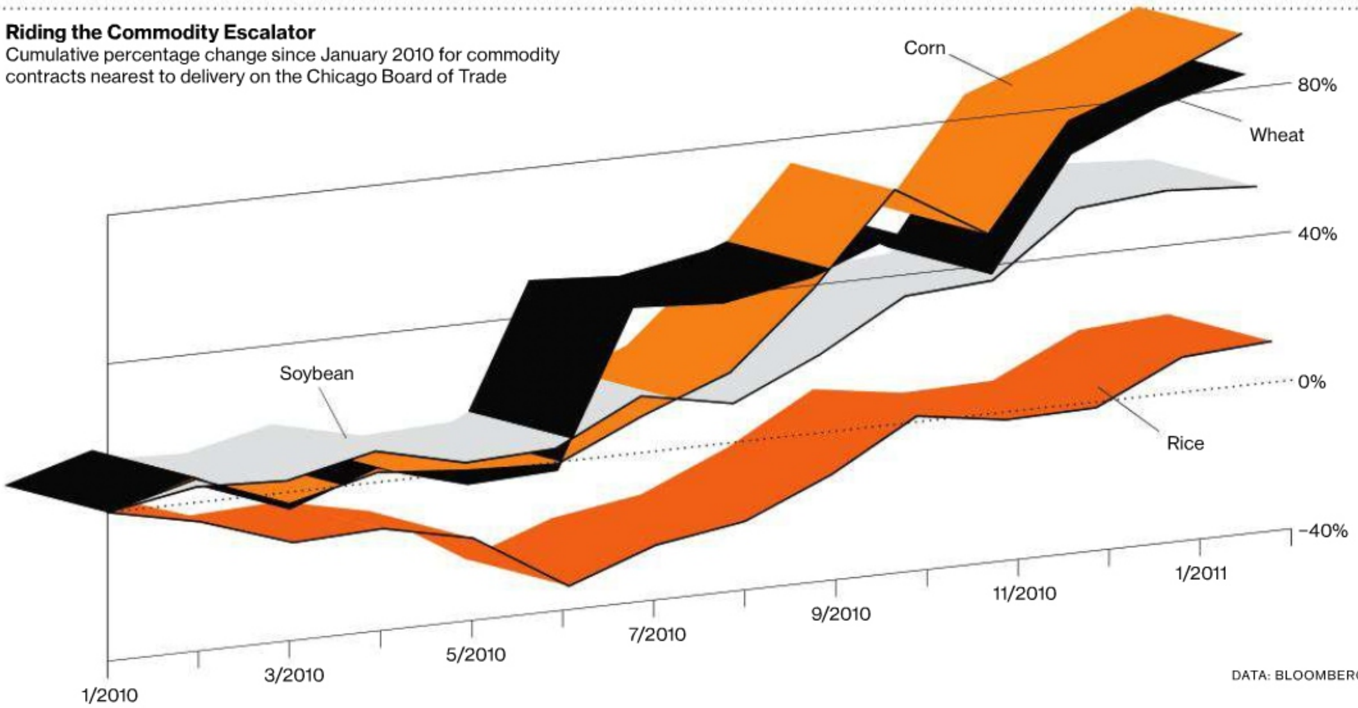
Rising prices for food are more likely to boost inflation in countries where growth is strong and unemployment is low. That's because in those countries, consumers pressed by food costs are more likely to get pay raises, says Karen Ward, senior global economist at HSBC in London. Once inflation creeps into wages, it quickly becomes general. China, with nearly double-digit economic growth, is an example. Chinese consumer prices rose 4.9 percent in January from a year earlier, the government announced on Feb. 14, while food costs rose 10.3 percent.

When demand is strong, as it is in China, companies are more able to pass along their higher costs by raising prices, says Rajeev Dhawan, director of the Economic Forecasting Center at Georgia State University's Robinson College of Business. In low-demand, high-unemployment economies such as the U.S., workers can't get higher pay to cover their rising food bills, so they cut back on other kinds of spending. Companies, too, are forced to eat their higher costs because they know raising prices will kill sales. In a weak economy, higher commodity prices are "like a further tax on your growth," says HSBC's Ward.

For central banks, rising commodity prices are a conundrum. They create two problems that demand opposite solutions. To combat their effect on inflation, a central bank should raise interest rates. But to compensate for sapped consumer spending power, the bank should lower rates. Which course each nation's bank follows will depend on local economic conditions—and on whether it fears inflation more than it fears recession.

The second great test posed by the global agriculture crisis is to wealthy countries and their financial systems—a chal-

Riding the Commodity Escalator
Cumulative percentage change since January 2010 for commodity contracts nearest to delivery on the Chicago Board of Trade



DATA: BLOOMBERG

WorldMags

WorldMags

lenge to respond in a manner that helps rather than hurts. There's no way to sugarcoat it: What's bad for the global poor has been good for the American farmer and the American investor. The same record food prices that caused riots in Algeria and export bans in India have led to the biggest-ever U.S. farm exports, sending Midwest cropland to record values and boosting profits for rural banks and equipment makers, according to a report by the Federal Reserve Bank of Kansas City. Higher incomes let farmers repay debt in the fourth quarter, reducing delinquencies and increasing profit for lenders. Income for U.S. farmers is expected to jump 20 percent this year, the U.S. Agriculture Dept. said on Feb. 14. Net farm income will total a record $94.7 billion, compared with $79 billion in 2010. Crop values will jump 18 percent, to $202 billion.

As agricultural commodity prices have risen, global investors have been piling into agriculture index swaps, exchange-traded products and medium-term notes. Investments in those products tripled, to $5.7 billion, in the three months ended Dec. 31 from the previous quarter, Barclays Capital said in a Jan. 27 report. New investments in agriculture-related products totaled $2.6 billion in December, compared with $1 billion in November and $1.3 billion a year earlier.

The question is whether Wall Street speculators are making commodity prices rise faster. At the height of the housing and stock market bubble that burst two years ago, speculators were accused of pushing up crude oil prices–to a peak of $147 per barrel for West Texas Crude in 2008–without regard to supply and demand. This led to calls for regulation that weren't answered until the Dodd-Frank financial reform bill gave new marching orders to the U.S. Commodity Futures Trading Commission. The CFTC has had trouble gathering accurate data on the derivatives markets, and it remains divided on how to regulate them. In a separate attempt to tame price speculation, the commission in January proposed stricter position limits, or rules on how many futures contracts investors can own at one time. These rules, if adopted, would affect a limited number of commodities and firms. Whether they will do any good remains to be seen.

Even before Dodd-Frank, investment in agricultural futures was subject to CFTC caps–and that alarm bell sounded a warning last week, when Deutsche Bank closed to investors its PowerShares DB Agricultural Double Long, an ETN based on commodities futures prices that's up more than 65 percent in the past year. A person familiar with the matter said DB feared that the product's underlying investments would soon hit their position limits.

"There is not one crop you can point to that is without supply problems"

Traders say they don't boost prices, because trading is a zero-sum game: For every buy, there's a sell. "Speculators will flock to a good, compelling, fundamental story," says Gary Mead, an analyst at VM Group in London. "If you take away that good, compelling, fundamental story, speculators will look at something else. In this low-interest-rate environment, they're searching for yield in whatever shape. Right now, it happens to be commodities."

Most American have not benefited from the food crisis. A record 43.6 million people in the U.S.–more than one of every eight–received food stamps in November, as the jobless rate stayed near a 27-year high, the USDA reported. In most parts of the developing world, there is no comparable safety net, which is why national leaders and nongovernment organizations alike are scrambling to devise solutions before the worst comes to pass.

Chinese Premier Wen Jiabao announced this month that Beijing will spend 12.9 billion yuan ($1.96 billion) to bolster farm production and fight the dry weather. Benjamin Wey, founder and president of New York Global Group, an advisory firm in Beijing and New York, predicts that the Chinese government, to avoid social unrest, will impose food price controls, making producers and distributors whole through subsidies. In Bolivia, Finance Minister Luis Arce says a portion of the $10 billion in his country's central-bank reserves should be used to increase loans to food producers and lower prices. The Obama Administration won G-20 backing last October for a billion-dollar Global Agriculture and Food Security Fund to get food aid to needy countries. In Ukraine, once the Soviet Union's breadbasket, Agriculture Minister Mykola Prysyazhnyuk urged the World Bank to create a world grain bank "to safeguard the global food supply ... and to avoid unrest and to avoid fear."

The World Bank has advocated a similar approach, calling for the establishment of small regional food reserves in disaster-prone areas. Bank President Zoellick also recommends targeted government aid for the poor, such as school lunch programs, and a free-market approach to price volatility, with governments promoting transparency and preventing restrictions on the flow of food. When the Group of 20 Finance Ministers meet this month, he will ask its members to endorse a code of conduct that would prevent them from limiting humanitarian food aid even if it violates export limits, produce better information on grain inventories in emerging economies, and improve long-range weather forecasts in at-risk regions such as sub-Saharan Africa.

The final test posed by the current crisis is the toughest of all. Scientists have been warning for years that carbon emissions from cars, planes, factories, and power plants would make the global climate warmer and more chaotic–altering weather patterns to make some places more prone to drought and others more prone to floods. And climate campaigners have been wondering for years what it would take to galvanize the U.S. and other nations into action. The newly ascendant Republicans in Washington won't acknowledge the existence of the problem, let alone debate its solutions. But other leaders are speaking up. In South Korea, when President Lee Myung Bak launched a task force to study food shortages, he was blunt: "There is an increasing likelihood of a food crisis globally," he said, "due to climate change." Business leaders are equally frank. "The fact is that climate around the world is changing," says Sunny Verghese, chief executive officer at Olam International, among the world's three biggest suppliers of rice and cotton. "That will cause massive disruptions."

Civilization has faced down pandemics and world wars–and has emerged stronger for having met the test. The current series of droughts and floods are not simply wreaking havoc on food supplies. They're harbingers of life in a hotter and more chaotic climate. Could hunger, and the threat to power that accompanies it, be what finally forces political leaders to act? B *—With Alan Bjerga, Peter Coy, Tony Dreibus, Luzi Ann Javier, Asjylyn Loder, Sandrine Rastello, and Jeff Wilson*

WorldMags



Summary prospectuses, if available, or prospectuses for the Funds containing more information may be obtained from your financial advisor. Please consider a Fund's objectives, risks, charges and expenses, and read the summary prospectus and the prospectus carefully before investing. The summary prospectus, and/or the prospectus contain this and other information about the Fund. ***gsam.com*** Goldman, Sachs & Co. is the distributor of the Goldman Sachs Funds. ©Goldman, Sachs & Co., 2010. All rights reserved.

WorldMags

WorldMags

Contents ▶ Egypt: The army's business empire 12 ▶ Swiss banks and strongmen 13 ▶ The Fed's A-Team 14 ▶ The Web hobbles the Hong Kong Jockey Club 16 ▶ Tom Keene talks to Robert Albertson 16 ▶ Charlie Rose talks to Shady El Ghazily Harb 18 ▶ The week ahead 19 ● Edited by Christopher Power



Why Italy Puts Up With Silvio Berlusconi

▶ The Italian Prime Minister has a strong Finance Minister and a core of loyal followers

▶ "The evil of Italy is a culture that makes Berlusconi a normal politician"

By his own reckoning, since becoming Italy's Prime Minister, Silvio Berlusconi has endured 105 judicial probes and trials and 2,500 court hearings and spent more than 300 million euros ($409 million) in legal fees defending himself against allegations of tax fraud, bribery, corruption, and more. That's 48,000 euros a day since he was first elected in 1994, when he parlayed his celebrity as a media baron and one of Italy's richest men into a political career.

No conviction of Berlusconi has survived Italy's tortuous appeals process, a fact the Prime Minister cites as evidence that his judicial tormentors are nothing more than closet communists who want to bring him down. His latest trial begins on Apr. 6. Prosecutors in Milan allege that the Prime Minister paid to have sex with a minor—a young Moroccan dancer whose stage name is Ruby Heartstealer—and that he abused the power of his office to cover his tracks. "I'm not the least bit worried," Berlusconi said on Feb. 16.

Salacious details of Berlusconi's off-duty life, like allegations of suggestive dances with young girls in the bunga-bunga room of his villa, have made Berlusconi the butt of jokes. From economist Nouriel Roubini's Twitter page: "Berlusconi's defense: I screwed all Italians for 15 years for free and no one complained; now that I screw one and pay her, they give me hell." In demonstrations on Feb. 13, hundreds of thousands of Italian women called for Berlusconi's resignation and an end to the sexism they feel he has done so much to promote. Their slogan: "If not now, when?"

The answer may be: not just yet. Berlusconi's People of Liberty Party and its allies cling to a tiny majority in Parliament. In a Feb. 8 poll about possible early elections, 61 percent of respondents said Berlusconi should resign. Yet the survey showed that voters abandoning Berlusconi may shift to his coalition partner, not the opposition, so his alliance maintained a 3 percentage point lead over the biggest opposition bloc. The Democratic Party, the pillar of the opposition, is stuck in the political wilderness, with three leaders in three years.



CLOCKWISE FROM TOP: ANTONIO SCATTOLON/A3/CONTRASTO/REDUX; LUCA BRUNO/AP PHOTO (3); MARCO SECCHI/GETTY IMAGES

WorldMags

WorldMags

With no compelling alternative, many Italians may vote for Berlusconi again if his legal troubles lead to elections before his term expires in 2013. He has a core following among voters who share his conviction that the Democratic Party is riddled with communists, or who admire him as Italy's ultimate self-made man and model of virility.

Berlusconi also has a secret weapon: Giulio Tremonti, his Finance Minister. While Tremonti has not reversed the widening economic divide between Italy and its main European Union partners, he has averted the kind of catastrophe that dragged down Ireland and Greece. That's an achievement, given that the International Monetary Fund last May described Italy's economic performance as "dismal." Among the failings cited were low productivity, a rigid labor market, and a bloated private sector. Italy's gross domestic product grew an average of 1.5 percent a year from 1999 to 2007, compared with 2.2 percent for the EU. Last year growth was a meager 1.1 percent, following a 2009 contraction in GDP of 5 percent.

A tax lawyer by training, Tremonti has kept the public accounts in order.

-1.1

PERCENT

Annualized rate of contraction in Japanese GDP, last quarter of 2010. Although Japan's economy contracted less than the 2.2 percent expected, it still fell behind China in size.

DATA: BLOOMBERG

He has tempered Berlusconi's populist instincts by playing bad cop to his boss's good cop. That meant blocking the kind of stimulus spending that helped turn Spain's 2007 budget surplus into a deficit of 9.3 percent of GDP by last year. "He is seen as the guarantor of fiscal discipline during a period when other governments were much more relaxed on the fiscal front," says Chiara Corsa, an economist at UniCredit Bank in Milan. As a result, Italy's budget shortfall was a manageable 5 percent of GDP last year.

Overall debt, though, remains almost 120 percent of GDP, vs. 76 percent for Germany. The yield premium that investors demand to hold Italian 10-year bonds over German debt has roughly doubled since early 2010. That is still less than half the gap between yields on German debt and the sky-high yields on Portuguese, Irish, and Greek bonds.

Tremonti, a northern Italian who first ran for Parliament as a Socialist and who regularly rails against the ills of globalization, is known for using creative methods to keep Italy's deficit in check. He has fashioned a series of amnesties for tax dodgers that pardoned their transgressions for a fee that was lower than the maximum penalties. In the most recent amnesty, Italians paid the government 5 billion euros to have 100 billion euros of undeclared funds regularized.

Both Berlusconi and Tremonti have gotten an assist from high household savings, which helped ordinary Italians weather the depths of the recent recession fairly intact, despite an 8.6 percent jobless rate. Private debt in Italy is only 42 percent of GDP, vs. 118 percent for Ireland. Tremonti has told EU authorities they should take this low private debt level into account when figuring out how to improve Europe's finances. EU authorities want mandatory debt reduction targets for the union's most leveraged states. Tremonti argues that Europe's debt crisis was caused by reckless banks and hedge funds, not public spending. "Public debt isn't the cause of the crisis. It's the medicine," he says.

Tremonti, 63, could end up succeeding the 74-year-old Berlusconi if his boss's position weakens dramatically and his party starts to disintegrate. For now, Berlusconi's supporters are defending their man and accusing the judiciary of trying to override the will of voters, who re-elected Berlusconi by a landslide in 2008.

Berlusconi's opponents, meanwhile, wonder if Italy can ever move beyond its fascination with the man. "We think the evil of Italy is Berlusconi," says Luigi Zingales, professor of finance at the University of Chicago Booth School of Business and a graduate of Milan's Bocconi University. "I think the evil of Italy is a culture that makes Berlusconi a normal politician. That is much more difficult to change." *—Andrew Davis*

The bottom line *While Berlusconi's reputation has been battered, he has no strong rivals and a respected Finance Minister.*

State Enterprise

Egypt's Army Marches, Fights, Sells Chickens

▶ **The country's generals run a network of businesses**

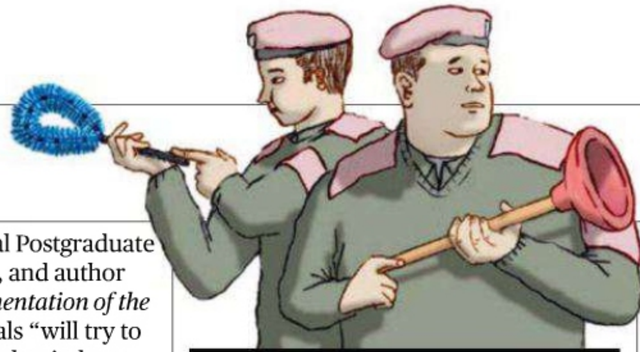
▶ **The military is "becoming a 'quasi-commercial' enterprise"**

The Egyptian military played a crucial role in the ouster of President Hosni Mubarak and has promised to steer the nation toward democracy. What's little known outside Egypt is that the army plays a crucial role in the economy as well. That raises the question: Will the military back reformers if they threaten to dismantle its business interests?

The armed forces have a substantial stake in Egypt's civilian economy through a host of government-owned service and manufacturing companies, at least 14 of them under the auspices of the Military Production Ministry. Military-run companies are in such businesses as janitorial services, household appliances, pest control, and catering. El Nasr Co. for Services and Maintenance, for instance, has 7,750 employees in such sectors as child care, automobile repair, and hotel administration, according to its website. Other military companies produce small arms, tank shells, and explosives—as well as exercise equipment and fire engines.

These companies add up to "a very large, unaccountable, nontransparent Military Inc.," says Robert Springborg, a professor in the department of national

WorldMags



The Egyptian Military's Odd Jobs

- Janitorial Services
- Pest Control
- Child Care
- Manufacturing
- Crane and Generator Rentals
- Agricultural Waste Management
- Lodging and Transportation
- Maritime Services

DATA: QUEEN SERVICE WEBSITE

security affairs at the Naval Postgraduate School in Monterey, Calif., and author of *Mubarak's Egypt: Fragmentation of the Political Order*. The generals "will try to massage the new order so that it does not seek to impose civilian control on the armed forces," he says. "It's not just a question of preserving the institution of the army. It's a question of preserving the financial base of its members."

As much as one-third of Egypt's economy is under military control, says Joshua Stacher, an Egyptian-military expert and assistant professor at Kent State University in Ohio. Revenues from military companies are a state secret, along with the armed forces budget, he says.

It isn't uncommon for governments and militaries to own or run their own defense-related industries and arms makers. In Singapore and Israel, for example, nationalized production of fighting hardware is seen as a way to protect national security by avoiding dependence on foreign arms contractors. What sets apart the Egyptian military, the Arab world's largest, is that its companies also offer an array of products or services in the domestic consumer economy–and without any civilian oversight.

The latest assessment of defense production and military companies in Egypt from defense information firm IHS Jane's in London, and a 1998 report produced by the American Embassy's commercial affairs section in Cairo, list three military-owned businesses that sell to both the armed forces and the public. One is El Nasr, which operates under the brand Queen Service. It has at least 18 service businesses, according to its website.

General Ahmed El-Banna, general manager of El Nasr, says the military owns 75 percent of the company while the rest is held by retired officers. Two other consumer companies were named by the reports: El Nasr Co. for Intermediate Chemicals, whose website says it produces chemicals, fertilizers, industrial and medical gases, and household pesticides; and Arab International Optronics, a maker of lenses and advanced optical equipment. No one answered the phone at Arab International Optronics, which doesn't have a website, and the number given by telephone information for El Nasr Co. for Intermediate Chemicals didn't answer.

Foreign Accounts

How the Swiss Freeze Crooks-in-Chief

Switzerland's decision on Feb. 11 to freeze the assets of former Egyptian President Hosni Mubarak is the latest action taken by the famously neutral country against a fallen strongman. The Swiss claim to have returned $1.8 billion in assets from dictators to their countries of origin in the last 15 years. Clawing back the spoils of corrupt regimes is no simple matter. —*Ira Boudway*



The Swiss Constitution allows the country's ruling Federal Council to freeze assets temporarily in anticipation of criminal charges being filed abroad to recapture the funds on deposit in Switzerland.



Under a 1981 law, Switzerland may cooperate in cases against "politically exposed persons." The demand for forfeiture must come from the country of origin. Failing that, the assets are returned to the original depositor or his heirs.



Last fall Switzerland passed the Restitution of Illicit Assets Act (RIAA). It allows the Federal Council to seize frozen assets in cases where the judicial system in the country of origin is inadequate.

1 Mobutu Sese Seko
Democratic Republic of the Congo

Assets frozen: **$6.7 million**

In 1997 the Swiss froze the assets of longtime dictator Mobutu at the request of the newly formed Democratic Republic of the Congo. After four extensions over 12 years and repeated attempts to help the DRC bring a case, Switzerland released Mobutu's assets in July 2009, effectively returning the money to his heirs.

2 Sani Abacha
Nigeria

Assets frozen: **$700 million**

In 1999, a year after the Nigerian military leader and de facto ruler died, the Swiss froze Abacha's accounts at Nigeria's request. In accordance with a 2005 agreement with the country, they have returned the money to Nigeria in installments for health and education projects.

3 Jean-Claude "Baby Doc" Duvalier
Haiti

Assets frozen: **$5.7 million**

When the Haitian President fled in 1986, the Swiss froze his assets at Haiti's request. Over the next 25 years Haiti failed to bring a formal case against the former dictator. The Swiss enacted RIAA and seized Duvalier's funds. Baby Doc's representatives will have a chance to prove the legitimacy of his wealth during forfeiture proceedings.

DATA: SWISS FOREIGN AFFAIRS DEPT., WORLD BANK

ILLUSTRATION BY LEIF PARSONS

WorldMags

WorldMags

The money behind the nominees page 24 ▶



The Ministry for Military Production lists on its website more than a dozen "military production companies," including Abu Zaabal Co. for Engineering Industries, Benha Co. for Electronic Industries, and Maadi Co. for Engineering Industries. Abu Zaabal was established to secure the armed forces' artillery needs, according to the website. It also produces water and fuel tanks.

Maadi makes parts for medical and agricultural equipment as well as home appliances, radiators, and exercise equipment. Benha owns factories and produces telecommunication equipment, microwaves, and personal computers. The Egyptian Tank Plant makes red firefighting vehicles.

In a secret cable signed by U.S. Ambassador to Egypt Margaret Scobey, the embassy in Cairo told Washington that the Egyptian military was "becoming a 'quasi-commercial' enterprise itself." The secret cable was dated September 2008 and was released last December by WikiLeaks. Although the cable didn't detail individual firms, it said the embassy's sources "told us that military-owned companies, often run by retired generals, are particularly active in the water, olive oil, cement, construction, hotel and gasoline industries." It also offered this view from embassy staff: "We see the military's role in the economy as a force that generally stifles free market reform by increasing direct government involvement in the markets."

The armed forces' business interests would be at risk if demands for opening up the economy ran too deep, said Samer Shehata, an assistant professor at the Edmund A. Walsh School of Foreign Service at Georgetown University in Washington, before Mubarak stepped down. "If the military was completely removed from politics, then there is no question that these interests would be put in jeopardy."

Military companies also play a significant role in consumer food production, says Springborg, the Naval Postgraduate School professor. The military runs "chicken farms, dairy farms, horticultural operations. And it of course has its own bakeries," he says.

The military's "business interests are very large," says Bassma Kodmani, executive director of the Paris-based Arab Reform Initiative and a senior adviser at the French National Research Council. Those businesses, though, help build the nation and keep capital within its borders. "The army is not seen as corrupt," she told a group of reporters in Paris last week. "It might seem strange to people in the West, but in Egypt it's not considered shocking that the army builds highways or new housing projects."
—*Cam Simpson and Mariam Fam*

The bottom line *The Egyptian military, which runs a large network of businesses, will defend those interests if they are threatened by reformers.*

Quoted

"Imagine if housing prices stabilize where we are, and then we slowly crawl back just based on the underlying level of inflation. That could take a decade to get back to where we were in 2006 in terms of home prices. So it's a shock."
—Christopher Whalen, Managing Director, Institutional Risk Analytics



Regulation

The Fed's A-Team Hunts for Signs of Risk

- **A new group of analysts and economists probes the banks**
- **"What do these guys really bring to the table?"**

Some of the biggest banks in America, such as **JPMorgan Chase** and **PNC Financial Services**, want to increase dividends over the next few quarters. When those dividends do go up, it will look like a vote of confidence by bank boards on the sustainability of economic growth and profits. The payouts will also be one of the most carefully screened moves by regulators in modern financial history.

The behind-the-scenes guiding hand of these bank board actions is a little-noticed team of economists, payment systems experts, bank examiners, and quantitative analysts at the Federal Reserve. The group was formed in early 2010 by Chairman Ben Bernanke and Governor Daniel Tarullo to hunt down risks in the financial system before they trigger another crisis.

Almost a year ago, the new Fed team, known as the Large Institution Supervision Coordinating Committee (LISCC)—which staffers pronounce "lis-sick"—helped Bernanke identify and respond to an emerging threat to the global banking system when U.S. money market funds began dumping European bank debt out of fear of a Greek default.

Now, the unit has given the directors of 19 banks, including JPMorgan Chase, PNC, **Citigroup**, and **Goldman Sachs**, a challenge: Before you hand out cash to shareholders, think about what might happen to you over the next nine quarters if unemployment rises and the economy falters. "The current review of firms' capital plans is another step forward in our approach to supervision of the largest banking organizations," says Tarullo.

If the bankers don't come up with a plan to have enough capital to withstand economic, regulatory, and lending risks, then the regulator is likely to challenge the dividend increases and ask for revisions, according to a set of guidelines issued by the Fed in November. "We came about as close as you can to the Great Depression. Regulators are going to err on the side of caution," says Joel Conn, president of money managers Lakeshore Capital in Birmingham, Ala. The pressure from the Fed may be working. At a Feb. 15 presentation, JPMorgan Chief Financial Officer Douglas Braunstein revealed that the bank's stress scenario for the economy was more severe than the Fed's.

LISCC also wants banks to plan for an array of new regulations that could lower profits. Another LISCC focus is the likelihood that investors in faulty mortgages may force the banks to take them back. Standard & Poor's estimates such a maneuver could cost the industry $60 billion.

Before LISCC's creation, the Fed's 12 reserve banks handled much of the day-to-day supervision of big banks and reported back to the Board of Governors in Washington, which sets the rules for bank holding companies. With LISCC, the Fed can tap its deep bench of more than 200 PhDs to figure out how a particular risk might

FROM TOP: ALBERTO E. RODRIGUEZ/GETTY IMAGES; SVEIN ERIK DAHL/JOHN WILEY & SONS/BLOOMBERG

WorldMags

WorldMags

We focus on automating Marriott's global invoice process. So they don't have to.

Xerox digitized and standardized the invoice process for Marriott Hotels & Resorts.® Now their 11 million invoices take less time to manage, and less space to archive. Which gives Marriott more time to focus on serving their customers.

RealBusiness.com

Ready For Real Business xerox



©2010 XEROX CORPORATION. All rights reserved. XEROX,® XEROX and Design,® and Ready For Real Business are trademarks of Xerox Corporation in the United States and/or other countries. All other logos, trademarks, registered trademarks or service marks used herein are the property of their respective holders.

WorldMags

Global Economics

affect the entire financial system or just a single bank.

The intense scrutiny of everything from compensation to stock buybacks shows the depth of the regulatory incursion into tasks normally handled by bank directors. E-mails revealed by the Financial Crisis Inquiry Commission showed the Fed even considered ousting Lehman Brothers Chief Executive Officer Richard Fuld and exercising "influence" over his successor. It's too much, says Wayne Abernathy, executive vice-president of the American Bankers Assn. and former staff director of the Senate Banking Committee under former Senator Phil Gramm (R-Tex.). "What do these guys really bring to the table that the leaders of businesses don't already know or have?" he says. "The answer is: the wrong set of incentives. Their incentive is to take no risk."

On the other side, financial regulators don't have high confidence in bank boards after the crisis revealed they didn't fully plan for events such as the fall in housing prices, says Alan Blinder, a Princeton University professor and former Fed vice-chairman. Regulators "would have loved to have left these issues, especially compensation, to boards if they exercised their responsibility," he says. Bank boards "blew it, big, big-time" during the financial meltdown.

$60 BILLION

Possible cost to banks if they have to take back faulty mortgages

To figure out if banks have enough capital, the Fed has asked the 19 largest banks to come up with at least two scenarios: a "baseline" on how the economy will probably perform and an adverse scenario. The LISCC has deployed Fed economists to come up with its own adverse scenario, laying down an official standard for what could go wrong. The Fed's worst case calls for a 1.5 percent decline in gross domestic product through the end of 2011, according to people familiar with the central bank's thinking.

The unit has also made one of the largest data requests in Fed history outside of normal regulatory reporting, asking for information in a range of areas, including loans and securities portfolios. This will allow the Fed to test any one bank's assumptions about the soundness of its portfolio against analysis of its own. Says Kevin Petrasic, an attorney at the law firm of Paul Hastings in Washington and a former special counsel at the Office of Thrift Supervision: "You have an entire industry that is now on parole." *—Craig Torres*

The bottom line *The Federal Reserve's specially assembled team of risk detectives will pressure the nation's largest banks to raise capital if needed.*

Gambling

For Hong Kong's Jockey Club, the Race is Online



▶ As websites woo bettors, the club is seeking new ways to compete

▶ The Internet "has eroded racing's capacity to ... achieve a fair return"

Over its 126 years, the **Hong Kong Jockey Club** has survived equine flu, the Japanese occupation, bribery scandals, and the end of British colonial rule. Now the club is looking to cope with its biggest challenge yet: the Internet. Though members still flock to the club's two tracks to sip Château Margaux and take in the races, a growing share of the money wagered is bypassing the club in favor of unauthorized betting websites. "Competition is just a mouse click away," says Winfried Engelbrecht-Bresges, 56, the club's chief executive officer. "Our competitiveness is at risk."

Unauthorized bookmakers–both online and offline–take bets on Hong Kong horse races equal to somewhere between 33 percent and 100 percent of the Jockey Club's receipts, the club estimates. Given that the club last year accounted for some 7 percent of Hong Kong's tax revenue, making it the city's biggest taxpayer, that would mean the government lost out on at least HK$2.6 billion ($334 million), based on the

→ 19

Tom Keene's EconoChat

Tom talks with **Robert Albertson,** chief strategist for investment bank Sandler O'Neill, on disposable income in the U.S.

You say in your report: Disposable personal income is "highly artificial." You call it a "dangerous aneurysm." That's strong language.
I don't know a better metaphor. An aneurysm is something you know is there. You just don't know when it will cause trouble. If you look at the consumer side of it, over the last 20 years you have had savings drained. Over the last 10, over half of consumer spending came from home equity withdrawals. Now we are out of the recession and consumer spending was up another $159 billion annually in the fourth quarter over the third. Forty-four percent of it came from lower savings and new debt. That is not sustainable.

That's not all you're worried about.
We need to ask what it would mean if we had a 100, 200 basis point increase in interest rates. What would it mean to housing? Here's a disturbing fact: A 30 basis point increase in interest rates for the government would completely wipe out everything Obama said in the last three months in terms of deficit and debt reduction.

Are you optimistic that we are setting up policies that will clear markets, particularly in housing?
The government is still focused on, I think, the wrong thing, which is to keep the cost of financing housing low. They need to focus on establishing sensible down-payment minimums and they must deal with the damage that already happened. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

FROM TOP: DALE DE LA REY/BLOOMBERG; ANDREW HARRER/BLOOMBERG

We focus on translating and delivering Ducati's global publications. So they don't have to.

Xerox authors, translates and delivers Ducati's handbooks and technical manuals. As a result, Ducati's costs have been reduced by as much as 23%. And the lead time for user manuals has gone from fifteen days to just one. Which leaves Ducati free to focus on building amazing bikes.

RealBusiness.com

Ready For Real Business xerox



©2010 XEROX CORPORATION. All rights reserved. XEROX,® XEROX and Design,® and Ready For Real Business are trademarks of Xerox Corporation in the United States and/or other countries. All other logos, trademarks, registered trademarks or service marks used herein are the property of their respective holders.

Charlie Rose talks to Shady El Ghazaly Harb

"We're begging [the military] to give us a chance ... nine months at least"



The 32-year-old Egyptian youth leader–part of a coalition that's trying to set the agenda for the future of his country–talks about the roadblocks to democracy that lie ahead

You've met with the military now. How is that process going?
We had just one meeting with them, a preliminary meeting just to organize ourselves and learn what they're thinking about. It wasn't a give-and-take meeting. And we said, "O.K., we need to meet you again because we now know what you're thinking, but you need to know what we are thinking." They welcomed that. They said, "Give us a call, and we'll try to meet you again later this week." We did give them a call. And they didn't give us any new timing for our next meeting. We're beginning to worry a bit.

You don't think they're interested?
We don't get that feeling. They just need to tell the public that they spoke to the youth.

What comes next?
We're looking forward to another meeting to tell them what we think is the plan for the near future. And especially that we have a lot of differences with them. If I may point out one or two: The first is the Cabinet. They're leaving the current Cabinet [in place] for some time. Most of it's from the former NDP officials, around 15 ministers are NDP members. [The National Democratic Party was in power without interruption since 1978.] And the public has not accepted that. The other thing, from our last meeting, they said that they're not planning to change that anytime soon, maybe three or four months, which I think we can't tolerate.

If you feel that things aren't going the way you expected them to, what do you do?
Well, as a matter of fact, today we are beginning to get this vibe, because this is the second time that they postponed the meeting. So if we don't get anything this week, we will get worried. We already have planned that there should be a gathering of a million in Tahrir Square this Friday [Feb. 18]. And it is going to be kind of celebrative, you know, for the revolution. But if we still get that vibe, and we don't get any positive feedback, we'll probably try to step it up a notch and maybe start demonstrations from different places in Cairo. Our most famous motto of our revolution was that the people want this regime down. That's our primary motto on Friday.

The Egyptian people are recapturing their dignity. What was it like being part of that?
We wanted to get out of the tyranny that we suffered from. We were fed up with a dictatorship, we needed to govern ourselves, and we really did need our dignity back. We all felt it when we were in the revolution, that we finally can get our heads up. And we were so powerless during the last 30 years that we thought that anyone can come and rule us, anyone can even give us away, inherit us like [Mubarak] was planning to give us to his son. But what happened on the 25th and especially on the 28th of January is that we said, "No, our dignity is good enough to resist all this. We're good enough for a better future."

Will this be known forever as the January 25th Revolution?
Probably, but we do have a problem, and I really need to tell you about it. Former NDP officials have nothing to do now, they are out of their jobs. So what they're thinking of right now, especially the latest secretary general, Hossam Badrawi, is forming a new party called the 25th of January's Revolution. They want to just seize that name and put it on a new NDP. That's one of our greatest fears now, because we don't want any person to steal the date of this revolution–it belongs to all the Egyptian people, from the far right to the far left, whatever their ideology is, because all of them have contributed some way or another.

Is anyone emerging as a leader you and your colleagues can support?
[Mohammed] ElBaradei was supposed to be one, but he denied any intention of running for president. I really can't guess now, but there is another important thing I would like to point out. This military council has suggested that they really want a quick handoff of power. And that means that they're going to do parliamentary elections within the next three or four months, followed by presidential elections. Doing that is going to be devastating for Egypt. It might seem that this is what we want–democracy as quick as possible and the military out of the picture–but I really beg to differ because the only organized political institution now that can run efficiently within three to four months is the Muslim Brotherhood. We don't want them winning the elections and then the army coming back and saying, "We'll have to come to power again." We're begging them to give us a chance, nine months at least, so that we can build ourselves and make up for the previous 30 years. Ⓑ



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

FROM TOP: AMR SOLIMAN/SOLILOS; BRAD TRENT

WorldMags

Global Economics

HK$7.9 billion in racing duties the club paid in the year ended last March.

Since Internet betting sites pay no Hong Kong taxes or track expenses, they can offer more attractive odds, says Engelbrecht-Bresges. Many are based in far-flung locations such as the South Pacific island of Vanuatu or Curaçao in the Caribbean, so outside authorities are powerless to go after them. "Online gaming has eroded racing's capacity to ensure it achieves a fair return from all the wagering that takes place," says Andrew Harding, secretary general of the Sydney-based Asian Racing Federation. While Hong Kong's gross racing revenue grew 3.6 percent, to $1.5 billion in the year ended in June, global Internet gambling last year jumped 10.4 percent, to $11.9 billion, say GBGC gambling consultants.

The Jockey Club is no stranger to the Net. Some 35 percent of the club's bets on horse racing now come through its website or mobile devices, up from 22 percent in 2006. Engelbrecht-Bresges wants the government to authorize the expansion of the club's betting operation into basketball and other sports to keep that share growing. The club's good reputation as Hong Kong's only track operator could help it build its online business because gamblers may not trust unregulated sites, says James Hollins, equity analyst at Evolution Group in London. "In the ideal scenario you have one brand and platform for sports, poker, casino, and bingo," says Hollins.

Another option for fighting online bookmakers is to link up with racing courses elsewhere to pool bets, a system that lets track operators offer better odds since more money is at stake. In Hong Kong, though, the Jockey Club's overseas revenue would be taxed both at home and in the country where the bet was made, eliminating any profit, Engelbrecht-Bresges says. The Hong Kong government said in an e-mail that it might consider a change in that policy.

An even bigger opportunity could lie on the mainland, where horse racing is banned. To attract Chinese high rollers, the Jockey Club spent $100 million on a clubhouse in Beijing. Says Engelbrecht-Bresges: "Ten years ahead, I'm pretty convinced there will be horse racing in China." B —*Frederik Balfour*

***The bottom line** With gambling websites taking revenues from the Hong Kong Jockey Club, managers there are looking for new ways to compete.*

Seven Days

Events of note in the week ahead

by Ira Boudway

21



Presidents' Day: Markets closed in the U.S.

Bank of Japan releases minutes from January board meeting

▶ **National Chip Week:** The U.K. celebrates the french fry with promotions and contests at chip shops throughout Britain.



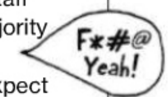
22

U.S. consumer confidence

Earnings from Barnes & Noble, Hewlett-Packard, and Home Depot



▶ **Chicago mayoral election:** Polls show former White House Chief of Staff Rahm Emanuel close to the majority needed to win without a runoff.



▶ **Wal-Mart earnings:** Analysts expect more than $118 billion in revenue.

23

Maersk annual report

Earnings from American Tower, DirecTV, and Toll Brothers

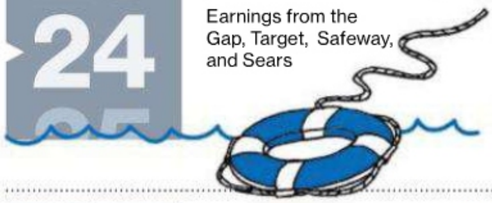
▶ **U.S. existing home sales:** Surveyed economists expect sales to decrease slightly from December's 5.28 million annual rate.



24

Brazil's unemployment

Earnings from the Gap, Target, Safeway, and Sears



▶ **AIG earnings:** The insurer took a net loss of $2.4 billion in the third quarter as it continues to sell assets to repay U.S. government rescue loans. Analysts expect nearly $14 billion in revenue for the fourth quarter.

25

U.K.'s fourth-quarter GDP

Mexico's leading economic index



▶ **Election day in Ireland:** The ruling Fianna Fáil Party is expected to suffer major losses in the first vote since the country accepted a $113 billion bailout from the EU and IMF.



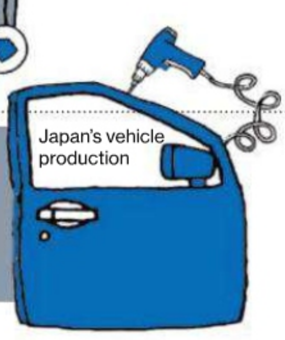
26



All Major League Baseball players report for spring training

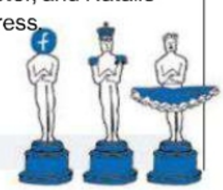
▶ **Olympic mascot election:** Polling begins in Russia to choose a mascot for the Sochi 2014 Winter Olympic Games. The candidates include a polar bear, a dolphin on skis, and the Santa-like character Ded Moroz.

27



Japan's vehicle production

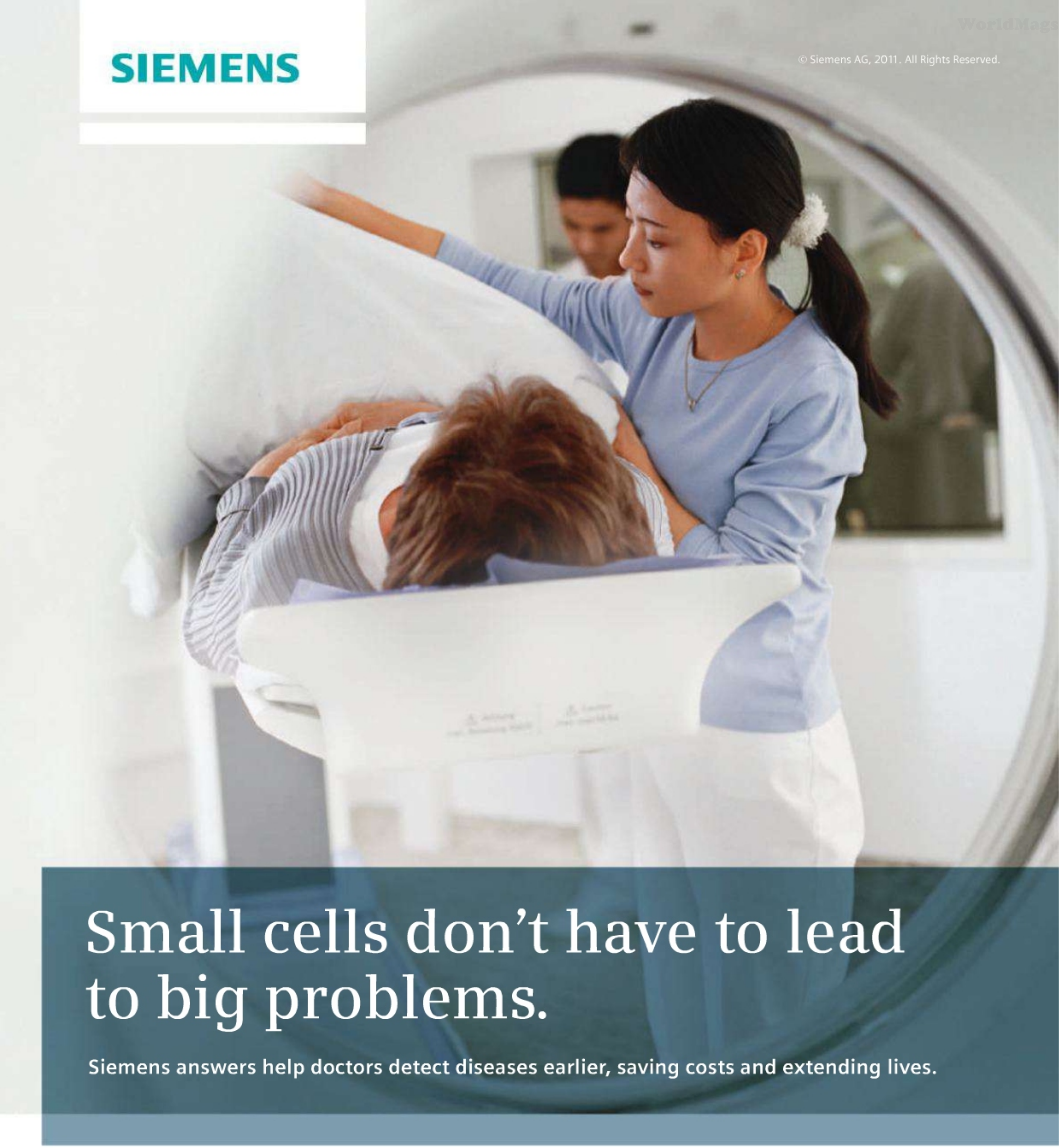
▶ **Academy Awards:** Las Vegas odds makers have *The Social Network* winning the Oscar for Best Picture, Colin Firth for Best Actor, and Natalie Portman for Best Actress.



For more events and interactive content, visit Businessweek.com.

ILLUSTRATIONS BY JULIA ROTHMAN

WorldMags
WorldMags



When diseases are caught early, they make less of an impact on everyone. That’s because 80% of today’s healthcare costs go toward treating late stages of illnesses like cancer and heart disease. With Siemens advanced diagnostic technology, doctors can accurately identify these dangers earlier. So patients get the treatment they need sooner. Somewhere in America, our team of more than 60,000 employees spends every day creating answers that will last for years to come.

siemens.com/answers

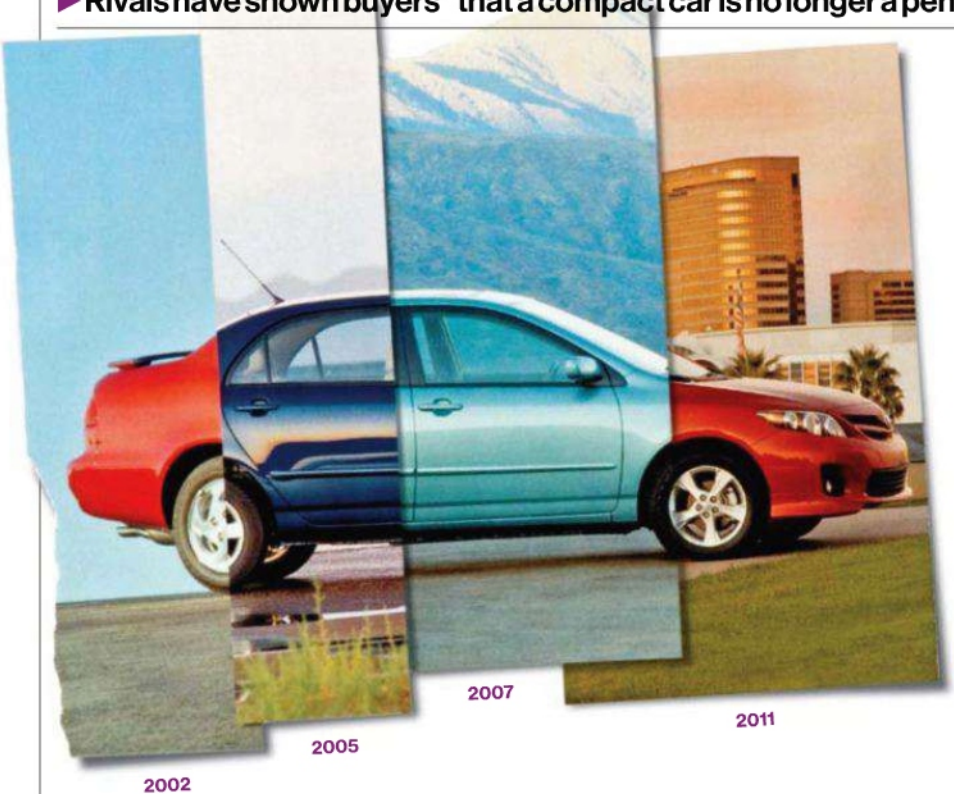
WorldMags

Contents ▶ A British fashion retailer opens a Facebook storefront 22 ▶ Anil Ambani's Indian empire faces troubled times 23 ▶ Ryan Kavanaugh of Relativity Media studio shows he's not just a money guy 24 ▶ Speed Dial: Starwood Hotels' Frits van Paasschen 25 ▶ Briefs 26 ● Edited by James E. Ellis

The Toyota Corolla: A Case Of Arrested Development

▶ The world's most popular car risks falling behind a pack of new competitors

▶ Rivals have shown buyers "that a compact car is no longer a penalty box"



When Doug Hacker of Milford, Ohio, began shopping for a small car recently, he figured the model he'd end up buying was a foregone conclusion. A self-described "Toyota guy," Hacker was inclined to go with **Toyota Motor**'s workhorse Corolla. The venerable compact is the Japanese automaker's No. 1 model as well as the world's best-selling car of all time, with cumulative sales from 1966 through last year surpassing 37 million units.

Well, the spell has been broken, at least in Hacker's case. After testing the Corolla, he was disappointed by the car's old-fashioned four-speed automatic transmission and the absence of a gas-sipping direct-injection fuel system. He decided to buy **Ford Motor**'s 2012 Focus instead. "I could not believe how outdated everything is," on the Corolla, he says.

Toyota has commanded headlines for much of the past year due to voluntary recalls of more than 8 million vehicles for everything from faulty fuel pumps to floor mats that could make accelerator pedals stick. Yet the world's largest carmaker faces another less noticed challenge: the aging of its biggest-selling model. Last updated in 2008, the current Corolla, which starts at $16,360, is the 10th generation of a model introduced more than 44 years ago. It isn't scheduled for a makeover until at least 2012, say industry analysts; the company is mum on a date. Meanwhile, a new crop of feature-laden small cars from Ford, **Honda Motor**, **General Motors**, and **Hyundai Motor** is arriving. Unlike the Corolla, these compacts offer popular features such as voice-activated controls, high-tech transmissions, and connections to computer networks.

While Corolla (including Matrix hatchbacks built on the same platform) managed to retain the top spot among U.S. small cars in 2010, sales fell 10 percent, to 266,082. The brand ended the year just 5,864 units ahead of Honda's Civic. Analysts expect a more challenging environment this year, thanks to Hyundai's hot-selling 2011 Elantra and a revamped Civic that's due out in May.

"Corolla has always had a tough place in the market. It's never been a style leader," says David Champion, director of automotive testing for *Consumer Reports* magazine. "The new cars coming out offer more style and content. They're really going to give Corolla a run for its money."

While the Civic remains Corolla's biggest rival, the 2011 Elantra is drawing attention for its flashy design, better fuel economy, and lower base price ($15,500) than the Corolla or the Civic. Meanwhile, Ford's new Focus compact, **Kia Motors**' Forte, and **Mazda Motor**'s Mazda3 are catering to U.S. buyers' interest in more stylishly designed small cars. The Focus seeks to attract buyers who want more European handling than the Toyota offers. Even GM, never a leader in small cars, is grabbing sales with its new Chevrolet Cruze, which boasts superior fuel economy and power relative to Corolla. "It's a small-car tsunami this year," says Jessica Caldwell, director of industry analysis at researcher **Edmunds.com**. "The only thing Toyota can count on is loyalty to the Corolla name."

Toyota's small-car leadership is at risk as competitors add technology and features to small cars, where sales have long been fueled by price and fuel efficiency alone, says James Bell, an analyst at industry forecaster Kelley

PHOTO ILLUSTRATION BY EMILY KEEGIN

WorldMags



The Corolla, America's small-car leader, is in a feature war with rivals

A fleet of small-car choices

Corolla's rivals are competing on price and features

Model	Price	MPG**	Features
Toyota Corolla	$16,360	28/35	Air conditioning, dual folding power mirrors, ABS brakes, 8 cup holders
Chevrolet Cruze	$16,995	26/36	Power windows, seat-back storage, OnStar subscription available
Ford Focus	$18,790	28/38*	Air conditioning, keyless entry, seat-back storage, Sync hands-free calling available
Honda Civic	$16,555	26/34	Power windows, telescopic steering column
Hyundai Elantra	$15,550	29/40	Automatic headlights, heated mirror, keyless entry, power windows, ABS brakes

*EXPECTED **CITY/HIGHWAY DATA: R.L. POLK

Blue Book (chart). "With Elantra, Focus, [and] even the Chevy Cruze, people are going to see what the standard is, and see that a compact car is no longer a penalty box," Bell says.

Bob Carter, group vice-president for Toyota brand sales in the U.S., recognizes the challenge. "The market is getting more competitive," he says. "I have a deep respect for Cruze, Focus, and Elantra." Still, he says rivals have their work cut out for them. "When you come to Corolla and the heritage and loyalty behind it, that's a lot for a competitor to overcome," says Carter.

The Civic, the top U.S. small car until Corolla toppled it in 2003, poses the toughest challenge. The version of the Civic shown at the Detroit Auto Show in January featured more aggressive body styling, with the company promising improved fuel economy and performance. (Final details are being kept secret until closer to the model's May debut.) Honda officials aren't gloating, at least publicly. Having Civic outsell Corolla "is not something we're chasing," says Christina Ra, a spokeswoman for Honda's U.S. unit. "There was a day when that was a goal," says Ra, but no longer.

To further the Civic's appeal to buyers seeking fuel economy, Honda is adding a conventional model that will deliver more than 40 miles per gallon in highway driving and is replacing the car's current hybrid version with a model using a lithium-ion battery pack.

Automakers facing such stiff competition typically maintain sales volumes by ramping up production and rolling out marketing incentives. Toyota can't easily do either. Last year, its joint venture factory with GM in California—the biggest source of Corolla production in North America—closed. A new plant in Mississippi won't start building Corollas until late this year. Until then, Toyota is getting cars from Canada and "importing some Corollas [from Japan], just filling in gaps," Carter says. That's an expensive proposition, given the yen's high exchange rate. Such are the dilemmas facing Toyota with a model that's showing its age. *—Alan Ohnsman*

***The bottom line** Toyota may lose market share because its aging compact, the world's top-selling car, hasn't kept up with rivals.*

Retailing

Flipping Friends into Customers



▶ Asos is the first retailer in Europe to set up shop on Facebook

▶ "There's money in this for all the players involved"

Sarah Townsend will no longer have to leave her 507 **Facebook** friends behind to buy the £35 ($55) baggy sweater she's been eyeing from **Asos**. On Jan. 27, the hip, London-based online clothing site became the first European fashion retailer to open an e-tailing outpost inside Facebook. Competitors such as **Gap** and **Inditex**'s Zara use the networking site largely to communicate with fans. Visitors to Asos's store on Facebook can shop the company's entire stock of 150,000 products without leaving the site. They also can post photos of items to their wall so friends can comment on potential purchases. "It's something I want to do more of," says Townsend, a 25-year-old marketing professional in London.

Asos and other retailers are going after consumers that marketing pros call "moppers"—as in mobile shoppers. Britain's No. 2 online retailer, whose name stands for "as seen on screen" (it has no physical stores), logged a 54 percent revenue increase, to $371 million, in the nine months ended Dec. 31. Analysts estimate pretax profit will reach $44.5 million this year. "Asos is leading the way," says Andrew Wade, a retail analyst at Numis Securities in London, who recommends clients buy Asos shares. "I'd expect to see other people do the same thing."

Moppers already use mobile devices to browse online stores, comparison shop, and get recommendations from friends. Making a purchase on their Android phones or **Apple** iPads is a natural next step. In the U.K. alone, mobile commerce is forecast to more than double by 2013, to $440 million, according to market researchers Verdict Research and Ovum.

Facebook says about 200 million of its 500 million members worldwide access the site via mobile devices. And these users are twice as active as those who use their home or work computers. The Palo Alto (Calif.)-based company is ramping up efforts in the U.S. to entice companies to sell their wares on its pages. Two that have already worked with developers to set up shop are **J.C. Penney** and **Delta Air Lines**. In three to five years, 10 percent to 15 percent of total consumer spending in developed countries may go through social networking sites such as Facebook, says Mike Fauscette, an analyst at research firm IDC in Framingham, Mass. "There's money in this for all of the players involved," he says.

At Asos, which also caters to shoppers in the U.S., Germany, and France, purchases from mobile devices amounted to just $1.5 million in

THIS PAGE: ILLUSTRATION BY MAAYAN PEARL; OPPOSITE PAGE: ANINDITO MUKHERJEE/EPA/CORBIS

WorldMags

WorldMags

December, or about 3 percent of its sales. The company expects that figure to start ticking up with the opening of its Facebook store last month. "Our [customers] are on Facebook all day, every day," says Chief Executive Officer Nick Robertson. For now the Asos store inside Facebook can only be accessed via a PC or an iPad. The company, which has close to 465,000 "likes" on Facebook, is at work on an app that will allow smartphone users to shop its site.

The owner of the world's largest e-commerce marketplace, **EBay** forecasts global mobile sales will double this year, to $4 billion. "Fashion is the biggest category for growth, and the U.K. is the fastest-growing market in Europe," says Patrick Munden, head of seller communications at eBay UK. British grocers are also seeing a rise in mobile transactions. **Ocado** reported that about 6 percent of orders in the first half of last year came through its "Ocado on the Go" smartphone app. **Tesco**, Britain's top retailer, upgraded its app in October to include a feature that allows shoppers to add products to their virtual shopping basket simply by photographing a product's barcode. Enjoying a good bottle of Chianti at a restaurant? Scan the label and it's yours.

Not all U.K. retailers are rushing headlong into mobile commerce. Jonathon Brown, head of online at department store chain **John Lewis**, says the retailer uses social network sites such as Facebook and **Twitter** as more of a "listening and protective tool" to respond to customer complaints and comments. Launching a transactional site on Facebook is something the company would consider, he added. Smartphones and iPads already generate about 5 percent of the traffic on its online store. A smartphone application that will offer fashion advice and buying guides are due to launch sometime in the first half of 2011.

For tech-savvy shoppers such as Townsend, who admits to a $160-a-month Asos habit, the new Facebook store could make it difficult to keep addictions in check. "I look at Asos probably every fortnight," she says. "It's the first place I go."

—*Sarah Shannon, with Olga Kharif*

The bottom line *U.K. fashion retailer Asos has set up shop on Facebook and will soon launch a smartphone app. The goal is to boost sales from mobile devices.*

Investigations

An Indian Tycoon Takes a Tumble

▶ **Fretting over a government probe, investors flee Ambani's ventures**

▶ **His companies' finances are "difficult to understand"**

Three years ago, when Anil Ambani ranked among the 10 richest men in the world, he had little problem raising $2.5 billion for an electric utility with no revenues and zero experience in the power business.

These days, the magic is gone. The Anil Dhirubhai Ambani Group, which controls Ambani's half-dozen public companies, has seen the value of its shares in those companies fall by nearly half–or $17.8 billion–since August 2009. That's when Kotak Securities issued a report saying Ambani's mobile phone operator, Reliance Communications, had engaged in "opportunistic" accounting tactics. The Mumbai brokerage earlier sparked a government audit of Reliance when it said the company had reported higher revenue numbers to investors than it had to India's telecom regulator.

On Feb. 9 an Indian accountants association said it had queried Reliance Communications about its finances, spurring investors to dump $2.6 billion worth of shares in Ambani's companies that day. Reliance has also been caught up in a long-running scandal involving the sale of airwaves to telecom companies. On Feb. 16, Ambani, 51, visited the Delhi headquarters of the Central Bureau of Investigations for questioning.

Institutional investors have sold over 8 million shares of Reliance Communications in the past year, Bloomberg data show, and Ambani lost $23.8 billion of his personal wealth between March 2008 and March 2010, *Forbes* estimates. "The main reason we lowered our stake was aggressive accounting," says Walter Rossini, who runs Aletti Gestielle, a fund that in December halved its holdings in Reliance Communications.

Ambani's group blames the stock declines on "baseless rumors ... and an illegal bear cartel" and has demanded an investigation by India's market regulator. Ambani is also chairman of Reliance Capital, which owns 18 percent of Bloomberg UTV, a television joint venture with the

$2.6
BILLION
Decline in value of Anil Ambani's public companies on Feb. 9



WorldMags

A budget from the Keynesian-in-Chief page 28 ▶

owner of *Bloomberg Businessweek*.

Anil Ambani's woes stand in sharp contrast to the fortunes of his older brother, Mukesh. The two split their father's vast empire in 2005 when he died without leaving a will. Mukesh, 53, kept oil and gas refineries, while Anil inherited younger, faster-growing businesses such as a telecommunications operator, power generation and distribution companies, financial services, and a construction company. Mukesh has built his Reliance Industries into India's most valuable company and managed to keep debt under control. While Anil has had some high-profile successes, such as a deal to fund films by Steven Spielberg's DreamWorks SKG, overall he "has been unable to deliver," says Jürgen Maier, a fund manager for Raiffeisen Capital Management with about $1.3 billion in emerging markets but no Ambani shares. Anil Ambani's finances are "difficult to understand and corporate governance is not very strong."

Total debt for Reliance Communications, Reliance Power, and Reliance Infrastructure exceeds cash by as much as $10 billion, Bloomberg data show. Reliance Communications burned through $477 million in the quarter ended Dec. 31, pushing available cash down to $327 million from $1.9 billion in the previous quarter, according to its cash-flow statement. Ambani failed to sell a stake in a transmission-tower subsidiary last year, and he's trying to sell 26 percent of the phone company. He "has to take some bold decisions now, [selling] off noncore assets and [reducing] debt," says Jagannadham Thunuguntla, chief strategist at SMC Capital in New Delhi.

Reliance Power is planning to spend at least $7 billion on power plants this year, research firm Sanford C. Bernstein reports, and on Feb. 14 Reliance said it only had $935 million left from its initial public offering three years ago. Typically, power companies provide a quarter of the cost of new plants and finance the balance, which would mean the company needs at least $1.75 billion to fund its investment plans. Reliance Power doesn't have that money, says Sanford Bernstein analyst Michael Parker. "Given what the stock is doing, they really can't raise all that much from the equities markets," Parker says. "And given what's going on with the group, the debt markets aren't going to look too good, either."

An Ambani Group spokesman says the companies are financially sound, noting that Reliance communications has loans from China Development Bank to cover its costly rollout of 3G service. Reliance Power has $1.5 billion in cash, he says, and won't need to raise any funds before the end of next year. Reliance Infrastructure has at least $750 million in cash and another $1 billion in investments that could easily be sold.

The trouble wouldn't be so acute if Ambani's companies were performing as well as they once did. Reliance Infrastructure saw net profit drop 40 percent, to $36 million, for the quarter ended Dec. 31 because of falling sales, the company says. Although Reliance Communications is India's second-largest mobile phone operator, with 125 million subscribers, competition is so intense that the cost of a phone call has fallen to just a half-penny per minute. The company blames the low rates for a 57 percent decline in net profits, to $106 million, for the December quarter. Says Naveen Kulkarni, a Mumbai-based analyst at MF Global Securities: "It's a pretty bad set of numbers. Disastrous."
—*Mehul Srivastava*

The bottom line *With its shares in the dumps and the government on its tail, Reliance Communications will have to work to regain the faith of investors.*

Entertainment

Ryan Kavanaugh Readies for His Close-Up

▶ **The Relativity Media chief has big hopes—and two Oscar contenders**

▶ **"He is a guy who seems to be able to pull rabbits out of his hat"**

Ryan Kavanaugh's emergence as a rising studio mogul was on display at the Golden Globes on Jan. 16 when Christian Bale gave a shout-out to the Hollywood financier as he accepted the supporting-actor award for his role as a drug-using former boxer in *The Fighter*. Backstage, the bearded actor joked that he singled out Kavanaugh, one of the film's producers, because "he said if I thanked him personally he would actually pay me for my next film."

Kavanaugh has been wowing Hollywood with deals since 2002. The 36-year-old former Internet investor with spiky red hair and a penchant for wearing brightly colored Keds has flooded studios with almost $8 billion in a series of private-equity-financed deals that eclipsed those placed by some of the more established Wall Street players. The whispers among Tinsel Town veterans were

➜ 25

The Green Behind Oscar's Gold

Financing facts about the 10 Best Picture nominees



Mogul who bet on more than one film
Ryan Kavanaugh
The Fighter, The Social Network

Biggest budget
Toy Story 3
$200 MILLION

Film with most siblings investing
True Grit
Executive Producers David and Megan Ellison (children of Larry)
Directors Ethan and Joel Coen



Largest initial payback (opening weekend box office as a share of production cost)
True Grit
65.4%

Median budget
Best Picture films
$21.5 MILLION

Smallest budget
Winter's Bone
$2 MILLION

Only film totally self-financed by studio
Disney/Pixar's *Toy Story 3*

Most producers
The Kids Are All Right
20

DATA: IMDB

CLOCKWISE FROM TOP LEFT: ILLUSTRATION BY TOPOS; ALEX BERLINER/BERLINER STUDIO/BEIMAGES/BLOOMBERG; BARRY BRECHEISEN/GETTY IMAGES

WorldMags

WorldMags

that Kavanaugh, the son of a Beverly Hills doctor, who invested in high-tech companies for clients before using his local contacts to move into film financing, wouldn't last.

Yet Kavanaugh not only remains welcome among the power lunchers at the private Soho House in West Hollywood, but his **Relativity Media** studio also works with some major Hollywood players such as *Avatar* director James Cameron and **Netflix** dealmaker Ted Sarandos. "He's surprised a lot of people who thought he was this young producer who only knew how to raise money," says Chris Albrecht, chief executive officer of **Starz**, the parent company of the Starz Entertainment cable channel. "He is a serious businessman."

With two films among the 10 nominated for Best Picture honors, Relativity could get a boost if *The Fighter*, which it produced, takes home the Oscar. The company, which has a deal to finance films made by **NBCUniversal**'s Universal Pictures and **Sony**, also helped fund Sony's hit *The Social Network*.

Kavanaugh has said he's building a film operation that has a far lower cost structure than Hollywood's traditional big players. Backed by **Elliott Management**, a hedge fund that manages $17 billion, Kavanaugh bought the distribution and marketing arms of Overture Films in July from John C. Malone's **Liberty Media**. Overture distributes films with a staff of just 45 people, fewer than many similar-sized rivals, by using computers to book theaters, keep track of prints, and monitor audience results.

Picking through Hollywood's castoffs, Kavanaugh in 2009 also bought Rogue Pictures, a maker of low-budget teen movies such as *Seed of Chucky* that had 30 pictures in development and a money-generating film library. He quickly created a website, The Rogue Network, where he pitches news and ads for future films to Rogue's 15-to-30-year-old fans. "We feel like we're a major studio," says Kavanaugh. "We can make

To limit risk, Relativity Media analyzes dozens of variables that could affect a film's potential performance



Kavanaugh has surprised Tinsel Town vets who predicted he wouldn't last

and distribute films just like everyone else in town."

When deciding which films to make, Relativity Media executives rely heavily on data. They use what they call a regression analysis—a computer deep-dive into dozens of variables that could affect a film's potential performance, such as genre, release date, and actor's appeal—before deciding to greenlight a film. The goal: limiting the company's risk.

Relativity Media hedges its bets on films in which it invests. Kavanaugh has agreed to fund as much as 75 percent of Universal's films, basically spreading the company's risks across a pool of films, investing in Universal's successes such as *Mamma Mia* to offset bombs such as *Land of the Lost*. (Relativity Media has produced some stinkers, including the Nicolas Cage medieval film *Season of the Witch*, which generated U.S. ticket sales of $24 million while costing Relativity Media $44 million to make and an additional $20 million to market, according to movie box office tracking site **IMDB**.)

Relativity tries to limit losses by filming in countries that offer lucrative tax incentives and selling off foreign distribution rights before a film is released, which people with knowledge of the company say can cover more than 60 percent of production costs. (They say such dealing helped limit Relativity Media's exposure to $8 million for *Season of the Witch*.) Offering a film later for airing on television brings in added revenue. "I know how hard it is to create a studio, but I am not going to bet against him," says Jon Feltheimer, CEO of **Lions Gate Entertainment**. "He is a guy who seems to be able to pull rabbits out of his hat."

The biggest coup so far has been sealing a deal with Netflix to digitally stream Relativity's films to its subscribers. The DVD subscription service last year was willing to pay more than **Time Warner**'s HBO and **CBS**'s Showtime for rights to the films, say two people with knowledge of the deal, quieting some critics who

Speed Dial
Frits van Paasschen

The chief executive of Starwood Hotels & Resorts Worldwide says Sheraton, its once-troubled business travel brand, is now fueling growth

How's business travel?
We saw a more precipitous decline during the recession than even after 9/11. We saw leisure travel come back in August 2009, and in the fall of 2009 we started to see business trips come back. Executives know they have to get out to get business. They can't just sit behind their desks.

How has business travel changed?
Consultants and lawyers don't want to meet in their rooms, but they want to have a place that's more discreet than the lobby. So we're enhancing our club floors. And I'm a fitness nut, so we're making sure our gyms are state of the art. We're thinking of all the different ways we can keep people in the hotel if not in their room.

What's behind Sheraton's success?
To resurrect the brand, we did a [$4 billion overhaul of] the 200 hotels in the U.S. We had learned from our W chain that people don't like to sit in their rooms, they like to hang out. The W is edgy, Sheraton is mainstream. So we created a social area for the mainstream, mostly business travelers, called the Link. It's a place where people can multitask.

Where are the biggest opportunities outside the U.S.?
Three years ago, half of the hotels we projected opening were in North America. Now 80 percent of our new hotels [are] going to open outside the U.S., almost entirely in emerging markets. We have 70 hotels in China and another 80 under construction.

—*Susan Berfield*

WorldMags

WorldMags

Companies&Industries

wondered whether Relativity could survive without large hits. "I wouldn't make a long-term deal with them if I didn't think they were going to stay in business," says Netflix Chief Content Officer Sarandos.

For now, Kavanaugh has to please only one investor: Elliott Management, which owns a 40 percent stake in Relativity. The New York-based hedge fund is happy with the financier's track record and even discussed backing a Relativity Media bid last summer to buy then-bankrupt **MGM Studios**. "Elliott believes that Relativity's progress over the past year is impressive," says Jesse A. Cohn, a portfolio manager at Elliott Management who oversees its investment in the studio. "As partners, we are focused on assisting the company as it grows into an innovative studio."

Kavanaugh's low-budget, limited-risk production philosophy may be changing. Relativity has given the green light to two films, each with budgets of up to $80 million: *Snow White*, with Julia Roberts, and the superhero fantasy *Immortals* that's being made by the team that created *300*, Warner Bros.' 2006 low-budget blockbuster about an ill-fated Spartan battle.

Meanwhile, Kavanaugh continues to charm Hollywood, which always has a warm spot in its heart for fresh cash. "He's more than just some money guy," says *Avatar* director Cameron, who produced the thriller *Sanctum*, in which Relativity owns a 50 percent U.S. distribution stake. When audience-tracking research for the movie showed its TV ads and theatrical trailers weren't reaching a young demographic, Kavanaugh started pitching it to Rogue's more than 30,000 monthly online visitors and got Cameron to use **Twitter** and **YouTube** to hawk the film. "He's young, he understands that stuff better than I do," says Cameron. "And the tracking started moving after we started doing it."

Kavanaugh's magic didn't extend to the box office, however. *Sanctum*, which cost $23 million to make, according to Cameron, opened on Feb. 4 and generated $19 million in ticket sales after 10 days, according to film site Box Office Mojo. Ⓑ —*Ronald Grover*

The bottom line *Financier Ryan Kavanaugh's Relativity Media is using rigorous data analysis, rather than instinct, to select its Hollywood films.*

Briefs

by Caroline Winter



Huawei Technologies
Awaiting Obama's verdict

The U.S. Committee on Foreign Investment, which reviews foreign acquisitions of U.S. companies, has called for China's No. 1 telecom-equipment maker, Huawei Technologies, to divest itself of 3Leaf Systems, a small California tech company it bought in May for an undisclosed sum. A group of lawmakers says China's access to 3Leaf's cloud technology could pose a security risk to U.S. computer networks. Similar concerns have stymied the Shenzhen company's attempts to expand in the U.S. in recent years. Huawei says allegations about the 3Leaf deal are unfounded and that withdrawing would harm its brand and reputation. The company is waiting for President Obama to weigh in on the issue.

América Móvil
Eyeing European markets

$5 BILLION

América Móvil, Latin America's No. 1 wireless carrier, says it may launch an offer for Polkomtel, Poland's largest mobile-phone company. Polkomtel's owners, which include Vodafone Group, are seeking a minimum price of $5 billion. América Móvil, which is controlled by Mexican billionaire Carlos Slim, is looking for a foothold in Europe as growth slows in the Americas. The company expects to add up to 17 million new mobile-phone customers this year, a 7.6 percent increase, compared with a gain of about 12 percent in 2010.

Home Depot
On a hiring spree

Home Depot is hiring more than 60,000 temporary workers in the U.S. and is adding permanent employees for the second year in a row. The home improvement retailer, which employs 317,000, is staffing up for the busy March-June selling season and bolstering sales efforts as unemployment eases and consumer confidence rises. Household purchases grew at a 4.4 percent annual pace in the fourth quarter, the fastest since the first three months of 2006, according to Commerce Dept. figures.



Zynga
Attracting pre-IPO investors

Zynga, the No. 1 maker of games for Facebook, is in talks to raise $250 million in funding from T. Rowe Price and Fidelity Investments at a valuation of as much as $9 billion, according to two people familiar with the matter. The rush to invest in fast-growing Web companies before they go public is drawing institutional fund managers who don't traditionally back startups. T. Rowe Price owns stakes in Twitter and Angie's List, and along with Fidelity previously invested in apps maker Slide, which was bought by Google last year.



Borders
Bankrupt, after a long struggle



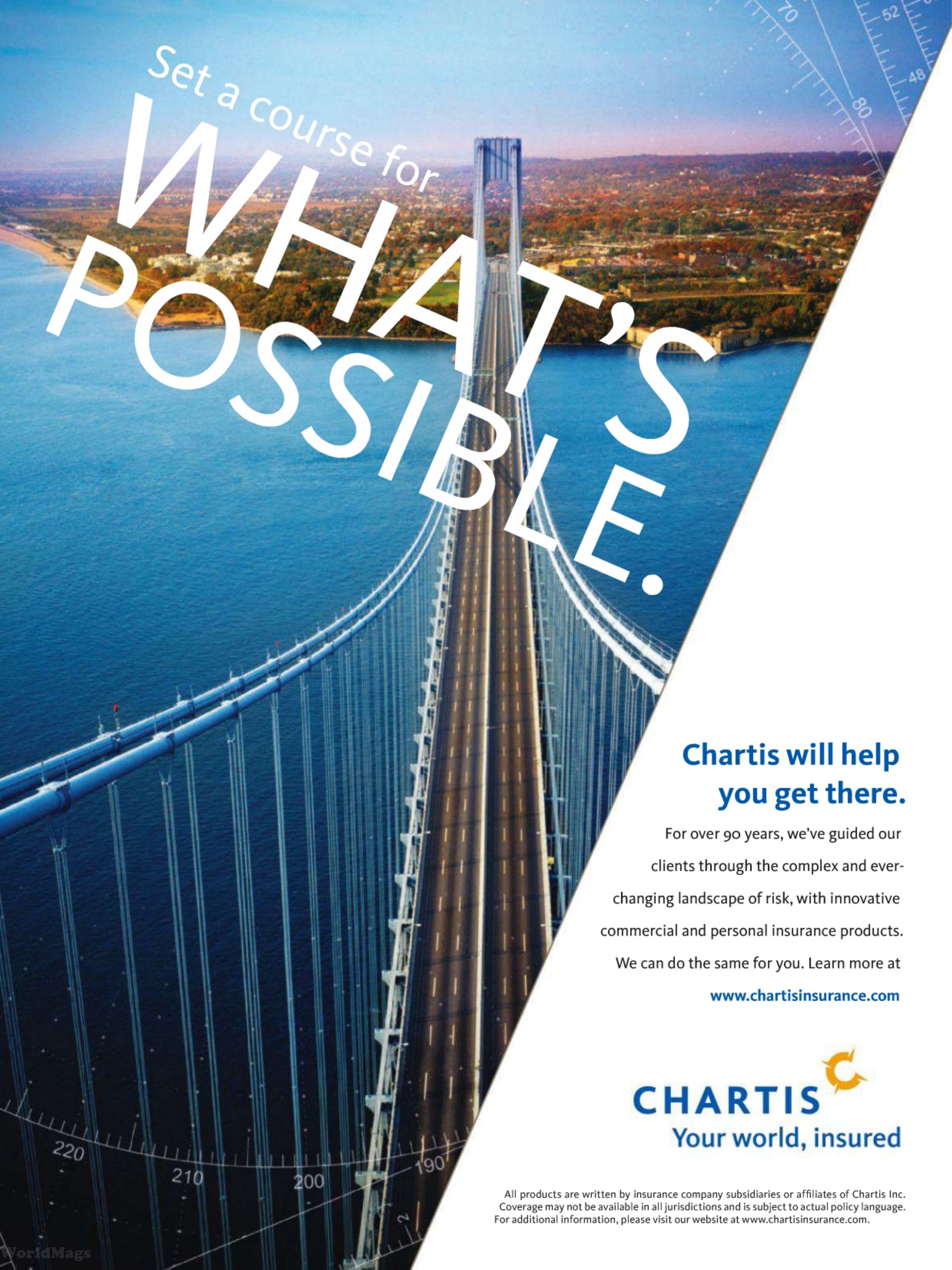
Borders, the No. 2 U.S. bookstore chain, filed for bankruptcy in New York on Feb. 16 after management changes, job cuts, and debt restructuring failed to make up for sagging sales in the face of competition from Amazon.com and Wal-Mart Stores. The 40-year-old chain says it may shut up to 43 percent of its 639 stores. It plans to restructure with $505 million in financing from lenders led by GE Capital. Borders's market value has fallen by more than $3 billion since 1998.

On the Move

Michelin CFO Jean-Dominique Senard appointed CEO ● **Nobel Biocare** Richard Laube to become CEO in May ● **Vitamin Shoppe** Anthony Truesdale named CEO ● **Carlyle Group** Adena Friedman appointed CFO

HUAWEI: JACOB KEPLER/BLOOMBERG; HOME DEPOT: SHANNON STAPLETON/REUTERS/CORBIS; BORDERS: RAMIN TALAIE/BLOOMBERG

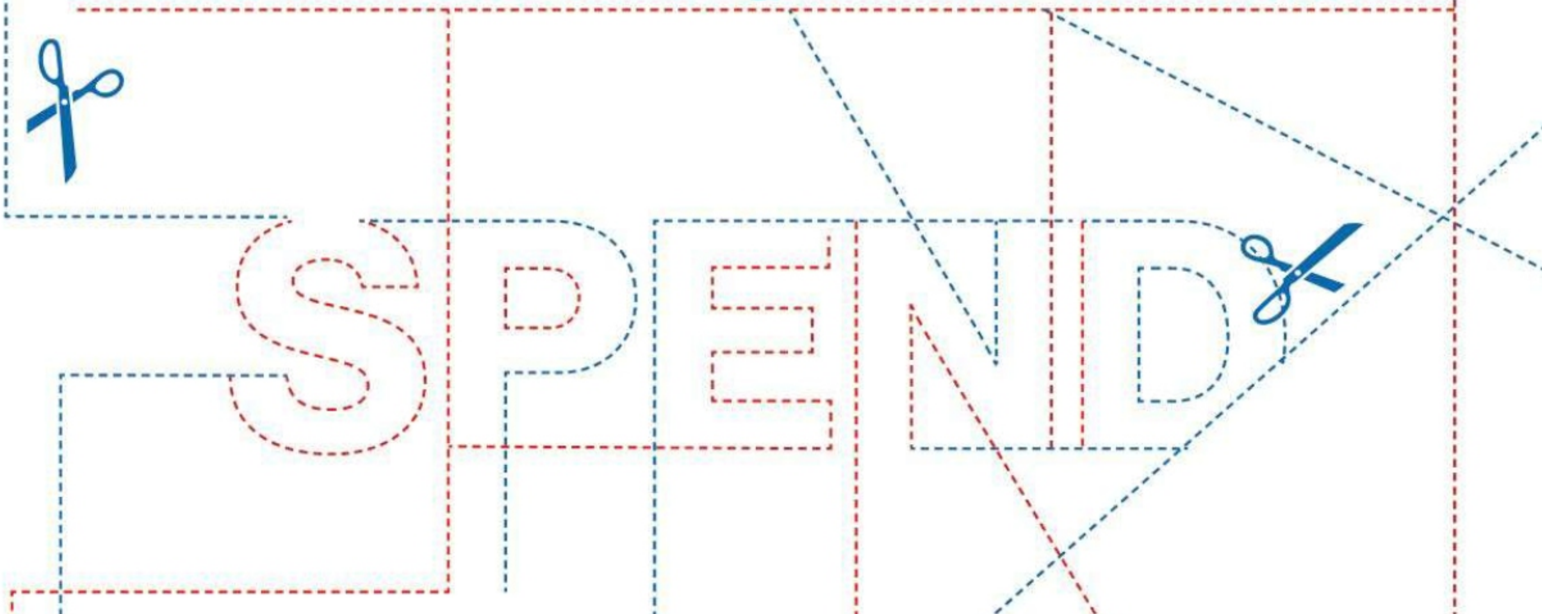
WorldMags


Set a course for
WHAT'S
POSSIBLE.
Chartis will help you get there.
For over 90 years, we've guided our clients through the complex and ever-changing landscape of risk, with innovative commercial and personal insurance products. We can do the same for you. Learn more at
www.chartisinsurance.com
CHARTIS
Your world, insured
All products are written by insurance company subsidiaries or affiliates of Chartis Inc. Coverage may not be available in all jurisdictions and is subject to actual policy language. For additional information, please visit our website at www.chartisinsurance.com.

WorldMags

WorldMags

Contents ▶ Tea Partiers party with lobbyists 31 ▶ Who will step in as Fannie and Freddie fade? 32 ▶ Obama's wireless plan: Needs improvement 33 ▶ Ouch! Governors are slashing Medicaid 33 ● Edited by Paula Dwyer



Obama's Budget and Its Discontents

▶ To Republican free-market purists, Obama's 2012 budget priorities smack of Keynesian interventionism

▶ "Continued uncertainty about our economic future is hindering job creation today"

President Barack Obama's first two budgets were reflexive, emergency-care responses—spending and more spending on stimulus, bailouts, and jobless benefits—to an historic economic bust. He did what he says he had to do. With the budget Obama sent to Congress on Feb. 14, his third, he's grasping hold of the country's fiscal levers to shape the U.S. economy according to his vision for the early decades of the 21st century. In other words: He's doing what he wants to.

The President's budget is informed by his belief that government has a strategic role to play in guiding the economy. That means in some cases picking winners and losers and directing capital to individual industries and technologies that have a shot at delivering jobs and economic prosperity. His Republican opponents believe it's better to let private investors keep more of their money, so they can allocate capital to where they think they'll get the highest returns.

So this year's budget debate in many ways harks back to the 1930s intellectual rumble between academic economists John Maynard Keynes and Friedrich Hayek. Democrats take their cues from Keynes, the Depression-era British economist who championed government intervention to correct economic imbalances. Republicans hew to Hayek and his free-market Austrian School of Economics, which views government intrusion into an economy as counterproductive at best, outright socialist at worst.

In his 2012 blueprint, Obama picks out the comparative advantages the nation should build up to compete globally. Chief among them is education: K-12 programs would get almost 7 percent more. Clean-energy technologies (electric vehicles, especially) get a Presidential thumbs up. So do high-speed rail and broadband Internet. Oil and gas companies, which stand to lose billions in subsidies, do not.

Of course, Obama's budget is a political as well as an economic document. With independent voters concerned about the size of the deficit, his budget would gradually reduce this year's shortfall from a projected record of $1.6 trillion, or 10.9 percent of the economy, to $607 billion in 2015. ➜

Line Item №1

Taking On the Deficit: Tax Increases

Obama's budget proposal would lower the deficit from 10.9% of GDP to just 3.2% of GDP by 2015. Around one-third of that reduction would come from tax and fee increases.

Ten-year revenue gains from...

Closing tax loopholes for profits made overseas
$129 bn

Repealing oil, natural gas, and coal subsidies
$46.2 bn

Taxing "carried interest" earnings
$14.8 bn

Hiking airline security fees
$3 bn

ILLUSTRATION BY TOPOS GRAPHICS

WorldMags



✔ YES, send my FREE Priority Mail® Flat Rate Shipping Kit.*

To get your FREE Flat Rate Shipping Kit:

- Mail in this card or
- Visit prioritymail.com/kit28

FIRST NAME | LAST NAME

TITLE

COMPANY NAME

ADDRESS | DEPT./MAIL STOP

CITY | STATE | ZIP™ CODE

E-MAIL ADDRESS | TELEPHONE

First, please tell us a few things about your shipping:

1. Who/where do you ship to? *Please check all that apply.*

☐ Businesses ☐ Consumers
☐ International destinations

2. On average, how many packages do you ship daily?

☐ <1 ☐ 1–4 ☐ 5–8 ☐ 9–19 ☐ 20+

3. Of your overnight and 2–3 day shipments, about what percentage are boxes compared to envelopes?

☐ 100% boxes
☐ 25% boxes/75% envelopes
☐ 50% boxes/50% envelopes
☐ 75% boxes/25% envelopes
☐ 100% envelopes

4. Have you used Flat Rate Boxes previously?

☐ No ☐ Yes, within the past year
☐ Yes, more than a year ago

5. What percentage of your shipping volume is with USPS®?

☐ None ☐ 1%–24% ☐ 25%–49% ☐ 50%–99% ☐ 100%

6. Number of employees at your location:

☐ 1–4 ☐ 5–9 ☐ 10–19 ☐ 20–99 ☐ 100+

* Offer ends 4/30/11 and is only available while supplies last. Offer valid for one customer per address.

Privacy Notice: For more information regarding our privacy policies, visit usps.com/privacypolicy

©2011 United States Postal Service. All Rights Reserved. The Eagle Logo and the trade dress of USPS Packaging are trademarks of the U.S. Postal Service.

EP11837

WorldMags

UNITED STATES
POSTAL SERVICE

PO Box 149263
Austin TX 78714-9263

NO POSTAGE
NECESSARY
IF MAILED
IN THE
UNITED STATES

BUSINESS REPLY MAIL®

FIRST-CLASS MAIL® PERMIT NO. 73026 WASHINGTON DC

POSTAGE WILL BE PAID BY ADDRESSEE

US POSTAL SERVICE®
PO BOX 149263
AUSTIN TX 78714-9632

WorldMags

Priority Mail® Flat Rate Envelopes. One rate to any state.



Priority Mail Flat Rate Envelopes, only from the Postal Service.™
Now available in various sizes. Just fill it* and ship it to any state for just $4.95.

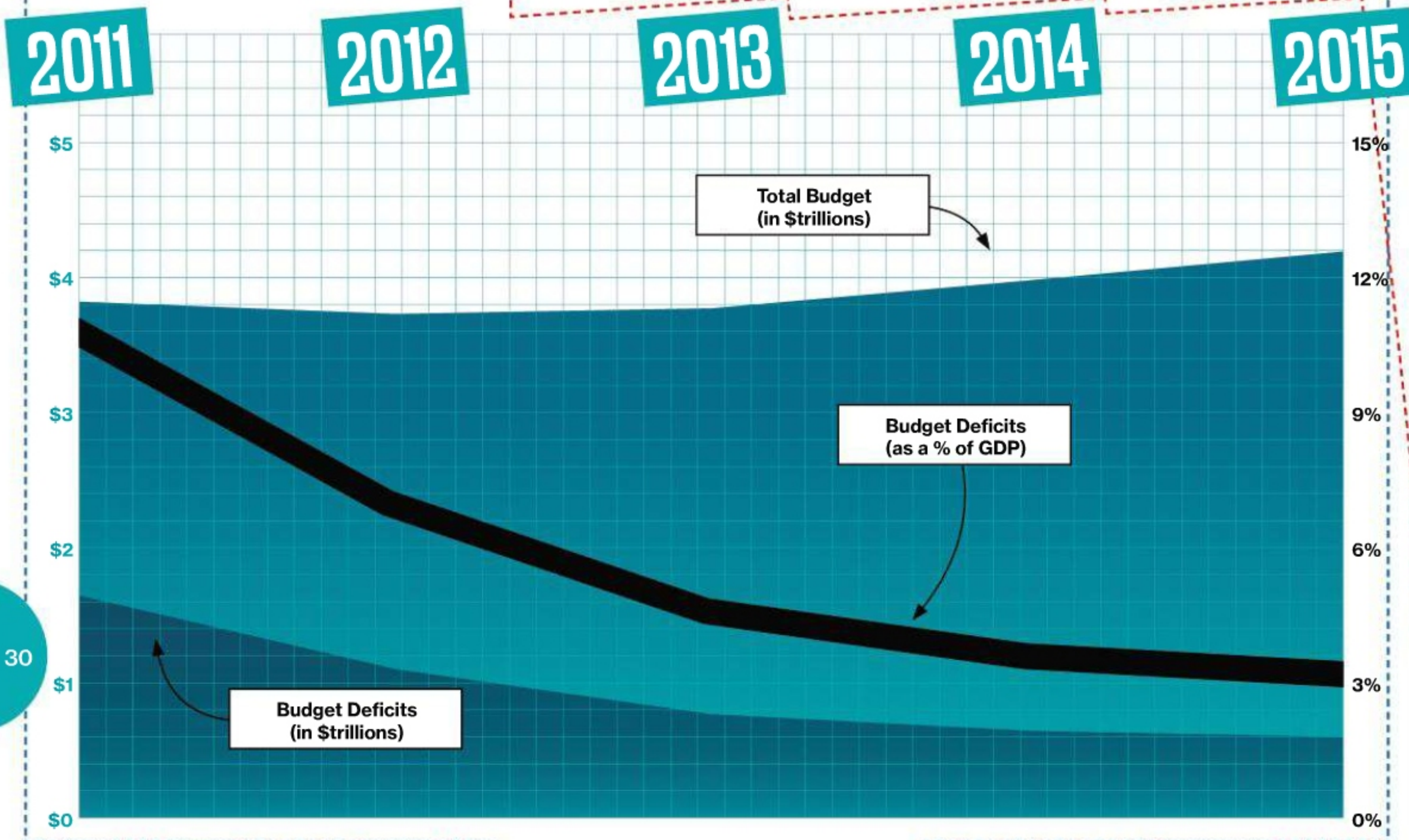
Order your free Flat Rate Shipping Kit† at prioritymail.com/kit28

Priority Mail® Flat Rate
A simpler way to ship.

UNITED STATES POSTAL SERVICE®

* For mailable items up to 70 lbs. Visit usps.com® for details.
† Offer ends 4/30/11 and is only available while supplies last. Offer valid for one customer per address.
Privacy Notice: For information regarding our privacy policies, visit usps.com/privacypolicy
©2011 United States Postal Service.® All Rights Reserved.
The Eagle Logo, the Letter Carrier Uniform, and the trade dress of USPS® Packaging are among the many trademarks of the U.S. Postal Service.®

Line Item №2



That's considered sustainable because, at 3.2 percent of gross domestic product, it will bring the growth of the national debt down to the economy's long-term growth rate. To get there, Obama must persuade Republicans to agree to $1.1 trillion in tax increases over the next decade, including $807 billion from rolling back Bush-era estate and income tax cuts for the wealthy.

While that may be optimistic, Obama is less rosy with his economic assumptions. He assumes jobless rates will average 9.3 percent this year and not drop below 6 percent until 2015. He also assumes the economy will grow at a modest 2.7 percent this year and build to 4.4 percent by 2013 before slowing slightly to 3.8 percent in 2015. Inflation is expected to remain tame at 1.3 percent this year and not to exceed 2.1 percent for the next decade.

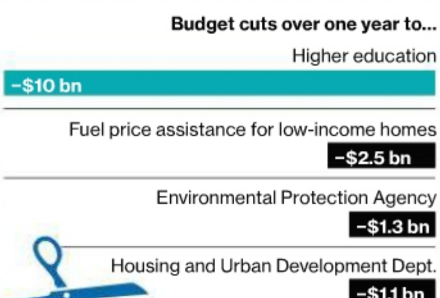
Republicans consider the deficit a prime culprit for the lackluster economy. House Budget Committee Chairman Paul Ryan (R-Wis.) argues for $61 billion in spending cuts over the final seven months of the current fiscal year as the best way to boost growth. "Continued uncertainty about our economic future is hindering job creation today," Ryan said at a Feb. 9 House Budget Committee hearing. "The explosive growth in our federal debt is by far the biggest source of this uncertainty."

The idea that a government should live within its means resonates with much of the American public, after many families had to make sacrifices during the recession. While the financial crisis may have cast doubt on the wisdom of markets, persistent high unemploy-

Line Item №3

Taking On the Deficit: Spending Cuts

The majority of the deficit reduction, around two-thirds, would come from cuts enacted over 10 years. Few programs and agencies were spared.

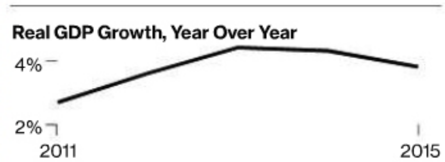


Line Item №4

Economic Assumptions Aren't Rosy

Most economic assumptions in the 2012 budget are in line with private economists' or Congressional Budget Office forecasts.





DATA: OFFICE OF MANAGEMENT AND BUDGET

FROM TOP: KEVIN LAMARQUE/REUTERS; MELINA MARA/THE WASHINGTON/GETTY IMAGES

WorldMags

WorldMags

ment and a record budget deficit have undermined confidence in the government's capacity to deliver prosperity. In a Bloomberg National Poll in October, 51 percent of respondents said Obama's stimulus either weakened the economy or made no difference.

To win back independents and executives, Obama, along with emphasizing education, would boost spending on transportation so manufacturers can move goods more quickly and cheaply. There's also a $1 billion expansion of health research that would assist biotechnology and pharmaceutical companies. "Now that we're out of the depths of the crisis," Obama said at a Feb. 15 news conference, "we have to look at these long-term problems and these medium-term problems in a much more urgent and a much more serious way."

At the moment, the White House and Republican budget sparring is confined to domestic discretionary programs, or about 12 percent of overall spending. The rest is for defense, interest on the national debt, and entitlement programs such as Social Security and Medicare. Obama and Senate Republican Leader Mitch McConnell of Kentucky on Feb. 15 signaled they would be open to negotiations to put entitlement programs on a sounder footing. A bipartisan group of six senators, including four who were on the President's deficit reduction commission, also has been exploring turning that panel's recommendations into legislation.

Over the coming months it will be clear that the White House and the GOP have deep differences, ranging from how fast to bring down the deficit to which domestic programs to cut. Some of these differences will come to a head soon. The temporary resolution funding the government expires on Mar. 4. Soon after, the government will reach its legal debt limit, requiring Congress to prevent a default. In each case, Republicans, especially newly elected Tea Party members, are hoping to use the occasions as leverage to reopen the debate on the appropriate size and scope of government. When they do, Keynes and Hayek, both now long deceased, will be there in spirit. —*Mike Dorning*

The bottom line *The 2012 budget debate could be a prelude to a bigger confrontation—or a grand bargain—over entitlements and the tax code.*

Campaign Finance

Tea Party Pols Embrace A Washington Tradition



▶ **Changing the culture takes a backseat to retiring campaign debt**

▶ **"Having fundraisers is what we do in office"**

Freshman Senator Mike Lee came to Washington as a standard-bearer of the Tea Party movement, vowing to change the capital's crony culture. The Utah Republican also came saddled with almost $64,000 in campaign debt. Now he's embracing one of Capitol Hill's time-honored traditions: repaying those IOUs with contributions from big business and other special interests.

On Feb. 10 corporate lobbyists feted Lee at a $250-a-head debt-retirement dinner at the headquarters of the lobbying firm Polaris Consulting. It was a chance to pay down what he owes, and pick up new donors, while 11,000 conservative activists and lobbyists were in Washington for the annual Conservative Political Action Conference. "No one that I'm aware of has said that once someone who believes in the need to change Washington gets to Washington that they shouldn't do what they can to make sure that their campaign assets are adequately funded," says Lee.

Freshman Representative Tim Scott (R-S.C.), who hosted a $500-a-person event the night before the CPAC confab at Sonoma, a Capitol Hill wine bar and bistro, put it more simply: "Having fundraisers is what we do in office."

Even Tea Partiers must stay financially solvent. To do so, they're reaching out to corporate political action committees with deep pockets and legislative wish lists. According to the Sunlight Foundation, a nonpartisan watchdog group, almost one-fifth of the 87 new Republican House members held fundraisers around the Feb. 10-12 CPAC gathering at the Marriott Wardman Park Hotel. Dozens more have held receptions in swanky Capitol Hill restaurants and corporate townhouses since their swearing-in last month. "A lot of members did say they were coming to Washington to change it," says Bill Allison, editorial director at the Sunlight Foundation. "It's very hard to change it when you are sitting down with the kinds of lobbyists who are interested in keeping the status quo."

Lee's overthrow of incumbent Utah Senator Bob Bennett in a Republican state convention last year was one of the first demonstrations of Tea Party power. His dinner was hosted by Microsoft lobbyist Frank Cavaliere and Polaris cofounder Bryan Cunningham, who has represented Microsoft, Verizon Communications, Southern Co., and AT&T, Senate records show. Microsoft spent almost $7 million last year to lobby on a range of issues, including an overhaul of the patent system. On Feb. 3 the Senate Judiciary Committee approved a patent reform bill, which Microsoft supports, that could give legal advantages to large companies that can file patents quickly. Brian Phillips, a Lee

$64
thousand

Amount owed by Mike Lee's Senate campaign as of Jan. 1



WorldMags

Total estimated U.S. mortgage debt **$11** TRILLION

spokesman, says the senator "will certainly evaluate the proposal and make a determination on the merits only" when it reaches the floor. Cavaliere and Cunningham declined to comment.

Freshman Representatives Dan Benishek (R-Mich.), Tom Reed (R-N.Y.), and Austin Scott (R-Ga.) made it easy for donors to give to the One Nation Political Action Committee, a fundraising group for Tea Party candidates, by holding what they called a Scotch & Cigars event in an executive suite at the Marriott. CPAC attendees could walk, checkbook in hand, across the hotel lobby to the smoke-filled room. The entrance fee, as high as $5,000 for PACs wishing to be listed as a "patron," entitled attendees to a "selection of whiskey, wine, and cigars as well as good conversation with fellow conservatives."

Across town, for donors who preferred action to small talk, the National Rifle Assn. hosted a "Laser Shoot Out & Hard Times Chili" for Representative Michael McCaul (R-Tex.) at the group's Washington offices. No real guns were involved; guests could play a video game that simulated hunting.

Notably absent from the CPAC festivities was Senator Marco Rubio (R-Fla.), who wowed last year's gathering with a fiery speech that won numerous standing ovations. This time, Rubio stayed in Florida in part to attend a fundraiser by the Republican Party of Pinellas County. In December he picked up more than $97,000 in contributions from the PACs of Caterpillar, Comcast, American Airlines, and others, Federal Election Commission records show. "It's all about Florida and getting back home and connection to real people," Rubio says of his decision to skip the event. And real money, too. —*Lisa Lerer*

The bottom line *With money to raise, Tea Partiers have been embracing the Washington ritual of mingling with lobbyists and special interests.*

Businesses Open Their Wallets

Corporate donations to Tea Party Republicans began shortly after the Nov. 2 election

Senator Rand Paul (Ky.)		
Kirby Corp.	11/5	$3,500
Fed. of Amer. Hospitals	11/15	$2,500
Senator Marco Rubio (Fla.)		
Comcast	12/16	$5,000
Tyco International	12/20	$5,000
American Airlines	12/22	$5,000
Senator Ron Johnson (Wis.)		
Honeywell	12/6	$2,500
Wal-Mart	12/7	$5,000
Time Warner	12/8	$5,000
Representative Steve Southerland (Fla.)		
Koch Industries	11/5	$5,000
Ernst & Young	11/16	$5,000
Publix	11/17	$5,000
Representative Bobby Schilling (Ill.)		
Marriott	12/14	$1,000
Caterpillar	12/27	$5,000
Wal-Mart	12/27	$1,000

DATA: FEC

Mortgages

Who Steps Up As Fannie And Freddie Fade Away?

- Overhauling housing finance depends on Wall Street
- The idea that the bond market isn't ready is "a red herring"

Treasury Secretary Timothy Geithner and Housing and Urban Development Secretary Shaun Donovan on Feb. 11 offered three options for shrinking **Fannie Mae** and **Freddie Mac**, the bailed-out housing finance companies that own or guarantee more than half the nation's mortgage debt. By gradually reducing the dominant positions of Fannie and Freddie, the officials hope to coax private financial firms and bond traders to take on more of the U.S. mortgage market's risk and revive the secondary market for home loans. One government misstep, and a shortage of home loan money could send loan costs soaring and home prices tumbling. "We want to be careful that the process happens in a way that doesn't interfere with or impede the process of repair in the housing market," Geithner said.

The first option laid out by the Administration would limit government backing to loans for narrowly targeted groups of borrowers such as lower-income families, veterans, and rural residents. This option is likely to push up interest rates and make the traditional 30-year fixed-rate mortgage hard to obtain, the report said. The second option would build on the first by adding an emergency government backstop that would ramp up in times of financial crisis. The third imagines the biggest government role through a reinsurance program for a broad class of mortgage-backed bonds in which the U.S. would come to the rescue if a primary insurer failed.

While Geithner and Donovan haven't said which they prefer, all three options depend on luring private lenders and, more important, the bond market, into the breach. One positive sign: **Redwood Trust**, a Mill Valley (Calif.) real estate investment trust, plans to test the waters. Redwood told regulators on Feb. 15 that it will offer $290 million of bonds backed by mortgages that average about $1 million a piece, considered jumbo loans because they exceed the government's guarantee ceiling, now $729,750. Redwood floated a similar bond last April—the first mortgage-debt offering without government backing in two years. The idea that the bond market isn't ready to step in is "a red herring," says Redwood Chief Executive Officer Martin S. Hughes.

Skeptics abound. The earlier Redwood offering, which bundled nearly $240 million in high-quality jumbo home loans, was "a triple-gold-plated deal just done for showing that the mechanics are still there" for securitization, says Michael S. Barr, a University of Michigan law professor who until December was an Assistant Treasury Secretary.

While the Administration debates what to do with Fannie and Freddie, it's proposing a series of small steps to entice investors back, including reducing to $625,500 the size of loans the government will guarantee and raising the insurance premiums that Fannie and Freddie charge. The idea is to drive up borrowing costs on mortgages backed by Fannie and Freddie to give banks more room to compete.

A misstep in shrinking the mortgage giants' roles could send interest rates soaring and home prices tumbling

CLOCKWISE FROM TOP RIGHT: NOAH BERGER/BLOOMBERG; SETH PERLMAN/AP PHOTO; RAMIN TALAIE/BLOOMBERG; JACK PLUNKETT/AP PHOTO; CHRIS HONDROS/GETTY IMAGES; MICHAEL DWYER/AP PHOTO; JOE RAEDLE/GETTY IMAGES; MANDEL NGAN/AFP/GETTY IMAGES

WorldMags
WorldMags

WorldMags

Such moves are likely to draw between $30 billion and $50 billion of new lender money, says Anthony "Tuck" Reed, a senior vice-president at **Wells Fargo**.

It's a start. Getting trillions of dollars into the game is another matter. That will require persuading burned investors to buy mortgage bonds again. Investors will demand iron-clad collateral, which means higher down payments. Even then, investors could resist. "No matter what the collateral–it could be gold bullion–investors won't buy it unless it has a government guarantee," says Guy Cecala, publisher of *Inside Mortgage Finance*, a trade publication in Bethesda, Md.

Viral V. Acharya, a finance professor at New York University's Stern School of Business, is more optimistic. "At some price, the private sector will come in," Acharya says. "The financial sector never leaves anything on the table."
—Lorraine Woellert and Jody Shenn

The bottom line *As Fannie and Freddie shrink, the Administration needs to coax Wall Street to accept more mortgage risk.*

Broadband

The Flaw in Obama's Wireless Plan

▶ **Fiber-to-the-home may spur the economy more than mobile**

▶ **Rural Americans "need just as much speed as someone who's in town"**

The residents of Ten Sleep, Wyo., know the meaning of rural. They didn't have phone service until the 1950s, when Tri-County Telephone Assn., a municipal co-operative, used federal subsidies to string copper wire to every home. In 2005 the co-op upgraded to fiber-optic cable, giving the town's 300 residents Internet access at 20 megabits per second. For the technically unfamiliar, Chris Davidson, Tri-County Telephone's general manager, describes this as "smoking fast."

Even President Barack Obama is impressed. On Feb. 10 he rolled out a national wireless plan, pointing to Ten Sleep as an example of what he wants to replicate nationally: Because of the town's high-speed fiber net-

➜

Health Care

Taking a Scalpel to Medicaid

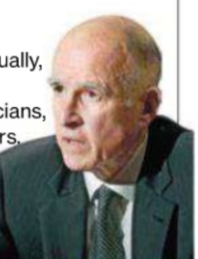
Costs for Medicaid–the largest item in most state budgets–are ballooning, and federal stimulus funds that have been shoring up the low-income health-care program run out in June. To trim costs, governors want to cut payments to doctors and hospitals, reduce benefits to recipients, and tighten eligibility requirements. Here's a look at eight key states:

Arizona
Gov. Jan Brewer (R)



Plans to drop 280,000 Medicaid recipients by tightening eligibility, saving $541.5 million next year. Halted funds for organ transplants in October; planning to slash payments to doctors and other providers by 5 percent on Apr. 1.

California
Gov. Jerry Brown (D)



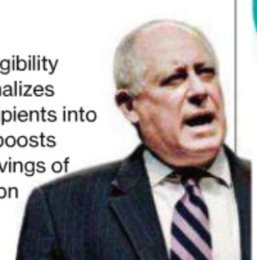
Wants to cut $1.7 billion annually, including $709 million in reduced payments to physicians, hospitals, and other providers. Aims to raise $557 million with co-pays of $5 for doctor visits and $100 for hospital stays.

Florida
Gov. Rick Scott (R)



A former hospital executive, Scott wants to cut payments to nursing homes, hospitals, and other providers by 5 percent. In 2012 he plans to cap Medicaid payments and expand a managed-care system to save $4 billion over two years.

Illinois
Gov. Pat Quinn (D)



A new law tightens eligibility requirements and penalizes fraud, shifts more recipients into HMO-type care, and boosts co-pays for drugs. Savings of as much as $774 million are projected over five years.

Massachusetts
Gov. Deval Patrick (D)



Expects to save $1 billion a year by putting coverage of more than 800,000 recipients up for competitive bidding, limiting payments for "preventable admissions" by hospitals, and imposing co-pays for some services.

New Jersey
Gov. Chris Christie (R)



Says he will propose Medicaid "efficiencies" this year. The state's program faces a $1.4 billion deficit when the U.S. ends $900 million of funding.

New York
Gov. Andrew Cuomo (D)



Has asked a team of experts to find ways of "taking the fat out" of Medicaid; aims for savings of $2.85 billion next fiscal year.

Texas
Gov. Rick Perry (R)



Wants Washington to give states more control over Medicaid spending. A proposed budget by state lawmakers would slash Medicaid reimbursements to long-term care facilities by a third and trim payments to hospitals by 10 percent.

DATA: BLOOMBERG

WorldMags

A bid to rescue Old Media—on the Web page 40 ▶

The area was 10 nights, or "sleeps," away from three Sioux encampments



Ten Sleep (Wyo.) residents get faster, cheaper Internet than most Americans

work, one company has been able to hire locals to teach English to Asians by video chat over the network. Obama hopes his plan will result in more such economic development by providing 98 percent of Americans with access to high-speed wireless Internet. "Ten Sleep," Obama mused. "I love the name of that town."

His plan, however, isn't likely to create more Ten Sleep success stories. It will direct $5 billion to the Federal Communications Commission's Universal Service Fund, the source of subsidies that Ten Sleep and other places tapped to build plain old telephone service. The money will help the FCC shift the fund's focus toward Internet access. The commission has released drafts for public comment that suggest the service will provide a minimum speed of 4 Mbps in hard-to-reach areas, most likely over a wireless connection. Using Davidson's measure, this is one-fifth of "smoking fast" and an even smaller fraction of fiber's potential. "Wireless wouldn't have helped us," says Rachel Casteel, a spokeswoman for Eleutian, the Ten Sleep company Obama cited.

The call centers and data-storage facilities that companies have placed in other small towns like Lebanon, Va., and The Dalles, Ore., demand the speed and capacity that only a fiber-optic backbone can provide. Davidson says he is encouraged by the fund's shift to Internet access but is unimpressed by the slower speeds. "People in rural America," he says, "need just as much speed as someone who's in town."

$24 billion

FCC estimate of the cost to bring high-speed Internet to every home

In the last century, electrification presented the same challenges. Large power companies saw little profit in rural counties. Many areas created municipal co-ops, with the mission of providing electricity or phone service while covering costs. It's not an accident that it took the Tri-County co-op, located in nearby Basin, to bring high-speed access to Ten Sleep. This is how fiber arrived in The Dalles and Lebanon as well.

But municipal co-ops are not part of the President's plan. In four states they are banned outright from entering the broadband business; in 14 others they are discouraged through regulation. Telecommunications companies maintain that municipal broadband is an unfair government intrusion into their markets. In its broadband plan last year the FCC suggested federal legislation to preempt such bans. So far there has been no action on that front.

Obama proposes to pay for his wireless plan–which includes money for research and a mobile network for emergency responders–by asking broadcasters to relinquish spectrum for government auction. The wireless carriers have been pressing for this, but nothing in the Obama plan encourages them to provide rural America with anything more than the minimum speed proposed for the Universal Service Fund overhaul. The President's beloved Ten Sleep does provide a model for rural broadband. It just isn't the one he's pursuing. Ⓑ
—Brendan Greeley

The bottom line *To harness broadband Internet for job creation and economic growth, Obama should stress fiber networks over wireless broadband.*

PHOTOGRAPH BY CHRISTOPHER WURZBACH BY BLOOMBERG BUSINESSWEEK


I wish the health care system could heal itself.
I will drink cold, stale coffee at 2 a.m. to get through 78 pages of a textbook, I will take on hours of research, and I will learn to help fix what is broken.
With the right education, the impossible becomes merely the challenging. Are you ready to learn what it takes to make a difference? To matter? Capella.edu
Capella University Matter
Accreditation: Capella University is accredited by The Higher Learning Commission and is a member of the North Central Association of Colleges and Schools (NCA), www.ncahlc.org. Capella University: Capella Tower, 225 South Sixth Street, Ninth Floor, Minneapolis, MN 55402, 1.888.CAPELLA (227.3552), www.capella.edu
WorldMags


Panasonic
ideas for life
Windows®. Life without Walls™. Panasonic recommends Windows 7.
intel CORE i5 vPro inside
Protect. Manage.
LORNE BROWN
Founder and VP of Sales
NEW YORK, NY
IN MY WORLD, THE ROAD IS MY OFFICE.
PANASONIC TOUGHBOOK COMPUTERS TAKE WHAT THE DAY THROWS AT THEM. My management team and I are always traveling, and our Panasonic Toughbook® laptops always stand up to bumps, drops and spills. And they're fast enough to run multiple applications. In the three years we've had them, we haven't had a single hardware failure, so the ROI has been significant. We've also saved thousands in Wi-Fi fees with the embedded mobile broadband. Today's Toughbook computers are even faster with the latest Intel® processors including the Intel® Core™ i5 vPro™ processor.*
1.888.223.1184 / panasonic.com/toughbook
EXIT 302B
106 39 WEST
Second Street
Main Street
1 MILE
6 SOUTH
Airport
EXIT 303
Park Street
TOUGHBOOK
FOR A TOUGHWORLD™
TOUGHBOOK®
Intel, the Intel logo, Intel Core, Intel vPro, Core Inside and vPro Inside are trademarks of Intel Corporation in the U.S. and other countries. Toughbook notebook PCs are covered by a 3-year limited warranty, parts and labor. To view the full text of the warranty, log on to panasonic.com/toughbook/warranty. Please consult your Panasonic representative prior to purchase. Panasonic is constantly enhancing product specifications and accessories. Specifications subject to change without notice. (*CF-31A, CF-52M and CF-52P are Intel® Core™ i5 vPro™ processor.) ©2011 Panasonic Corporation of North America. All rights reserved. Operative_H_FY10-2
Toughbook U1 Ultra
Toughbook F9
Toughbook H1
Toughbook 31*
Toughbook 52*

Technology



Mobile Wars!

▶ **After Nokia's software surrender, the five-way struggle for mobile dominance heats up**

▶ **"The game has changed from a battle of devices to a war of ecosystems"**

It's been a big couple of weeks in mobile. **Verizon Wireless** finally got the iPhone. **Hewlett-Packard** unveiled the first fruits of its Palm purchase last year. **Nokia**, the world's biggest handset maker, abandoned its once-dominant Symbian mobile software system and demoted itself to a kind of glorified contract manufacturer of **Microsoft**-powered devices.

The struggle for mobile dominance has entered a new phase. Why would Nokia throw out Symbian, with its 37 percent market share, in favor of software with less than one-seventh of that? Because recently hired Chief Executive Officer Stephen Elop is convinced that Microsoft has better odds of going up against the four other mobile powers—**Apple**, **Google**, **Research In Motion**, and HP—and making its new Windows Phone 7 software a center of gravity for the world's programmers, manufacturers, and consumers. "The game has changed from a battle of devices to a war of ecosystems," Elop told investors at a London press conference on Feb. 11.

Actually, it's the same game that created the most valuable franchises in tech history, from **IBM** to Microsoft to **Facebook**. All successfully established themselves as "platforms," in which countless entrepreneurs and programmers developed technologies that gave value to customers and profitability to shareholders—sucking oxygen away from rivals all the while. In the 1960s, IBM trounced Sperry and other mainframe makers by creating a soup-to-nuts stack of hardware, software, and services. In PCs, Microsoft erased Apple's early lead by signing up hardware makers to create cheap machines, and software companies to develop Windows versions of everything from word processors to Tetris.

What's different this time is scale. "Mobile is the biggest platform war ever," says analyst Whyman

Facebook vanquished social networks such as **Myspace** by repositioning itself as a platform—a decision that led to the creation of gamemaker **Zynga** and other app companies that keep Facebook's 500 million users hanging around.

What's different this time is scale. "Mobile is the biggest platform war ever," says Bill Whyman, an analyst with International Strategy & Investment. More smartphones were sold than PCs in the fourth quarter, and sales should reach $120 billion this year. That doesn't count billions more in mobile services, ads, and e-commerce.

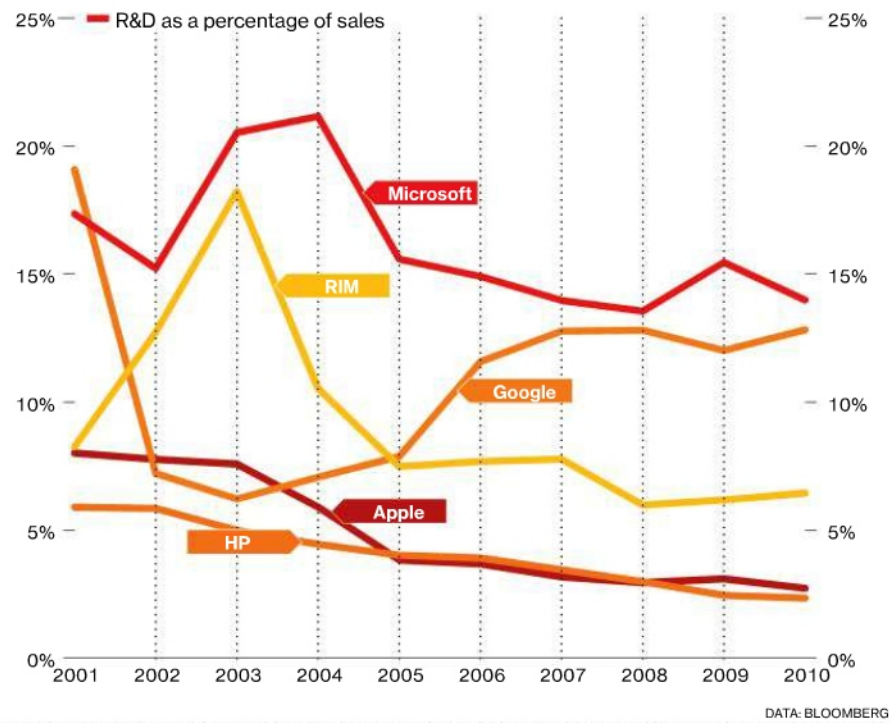
This war will probably last for some time, too. Unlike with PCs, where the unquestioned victor—Microsoft—quickly emerged and enjoyed years of near monopoly, no one has a divine right to dominance in mobile. Microsoft crushed its competition by forcing consumers to make a choice. There were far more software applications for PCs, and most didn't work on Macs. The more Microsoft-powered machines out

ILLUSTRATIONS BY ALEX EBEN MEYER

WorldMags

Technology

Bang for the R&D Buck
One result of Apple's strong platform: It doesn't have to spend big to create hits. Only HP, which bought rather than built its way into mobile, spends less on R&D as a percentage of sales



there, the more people wrote software for them, the more people bought them, and the bigger the whole ecosystem became. Economists have a name for that phenomenon: "network effects."

All cell phones can talk to each other and handle the same websites and e-mail systems, so winning means making products that function more effectively and appealingly. That sums up Apple's success. Steve Jobs figured out long ago that when people spend their own money, they'll pay for something a lot nicer than the unsexy gear the cheapskates in corporate procurement choose. While others competed on price, Apple focused on making its products reliable and easy to use. Once customers buy an iPhone and start investing in iTunes songs and apps, they tend to stick with the ecosystem and keep buying—even though there's no proprietary lock on the proverbial door. Apple's huge sales volume makes carriers and suppliers more likely to agree to its terms. The software that powers everything Apple makes—all variations of the Mac operating system OS X—is as intuitive to developers as Angry Birds is to app shoppers.

The result is economic leverage of staggering power. To create a blockbuster, Apple doesn't need to spend billions on a start-from-scratch moonshot of a development project. It just needs to tweak a previous hit. Take the iPad, which is in many ways a large iPod touch. Apple won't say how much the iPad cost to develop. Consider these numbers, though: In the year ended Sept. 30, during which Apple introduced the iPad and the iPhone 4, the company spent $1.8 billion on research and development. Over the same period, Apple's revenue increased by $22.3 billion. Nokia spent three times as much as Apple on R&D—$5.86 billion—and increased revenue by just $1.5 billion. No wonder that Apple, whose share of total global mobile-phone sales is only 4.2 percent, gets more than half the industry's profits, according to research firm Asymco.

Even Google, Apple's mightiest rival, got only a $5 billion increase in sales on its $3.4 billion R&D budget. It does have plenty to show for its efforts, though: Its Android ecosystem is growing at a blistering pace. In the fourth quarter, according to research firm Canalys, twice as many Android devices shipped as iPhones. "Google is being far more aggressive in building its platform than Microsoft ever was," says Bill Gurley, a partner at Benchmark Capital.

Barring big surprises, the other contenders—RIM, HP, and Microsoft—are in for a slog: too dependent on mobile devices to give up, yet lacking the tools to make much progress. All lost share in 2010 and have orders of magnitude fewer apps available for their devices. RIM still has legions of loyal BlackBerry fans, though developers routinely complain it's more difficult to create apps that run on those devices; that would help explain why RIM may be working on a technology so its devices can also run Android apps, as Bloomberg News recently reported. HP has the opposite problem: sweet technology and little foundation to build on. The company wowed the standing-room-only crowd that came to its Feb. 9 smartphone and tablet unveiling; attendees oohed when former Palm CEO Jon Rubinstein showed how to move a song or contact between phone and tablet just by tapping on the glass. Still, HP has spent years being a member of ecosystems—in particular, Microsoft's—rather than building its own.

Then there's Microsoft, a company that knows from platform wars. Millions of Nokia handsets will someday come with Windows Phone 7, the first model perhaps by the end of this year. Windows Phone 7 wins nods of approval from techies around Silicon Valley. Yet in a poll of developers by brokerage Sanford C. Bernstein, not one named it as their first or even second priority. Nor are the carriers quivering with excitement. "I do want a third strong OS out there," **Verizon Communications** Chief Technology Officer Anthony Melone recently told CNET. "But I still have doubts whether Microsoft will get the traction they are hoping for with Windows Phone 7."

The best hope for the mobile also-rans is that Apple and Google get greedy. On Feb. 15, Apple announced a subscription service that could force companies with hit apps, such as **Rhapsody**'s music-streaming service, to share some of their revenue with Apple. The same day, **Vodafone** CEO Vittorio Colao com-



COLORBLIND IMAGES/GETTY IMAGES

Don't be lulled by the stock market's calm page 45 ▶



plained that Apple and Google needed to absorb some of the massive bandwidth costs required to handle all those iTunes downloads and YouTube clips.

Even with a little overreaching, though, Apple and Google will be hard to beat. And it's not just they, says International Strategy & Investment's Whyman. "It's the whole ecosystem. You're competing with all the companies who have a vested interest in those platforms." —*Peter Burrows*

The bottom line *Apple and Google dominate mobile. The other big players—HP, Microsoft, and RIM—will have a hard time catching up.*

Social Media

A Twitter Knockoff Has China Talking

- ▶ **Weibo dominates the micro-blogging market**
- ▶ **It is "by far the best platform for free speech" in the country**

Ye Fangzhao, a 31-year-old freelance brochure editor for auto companies, abandoned Twitter a year ago to start using Sina Weibo, China's homegrown equivalent. Now he's on the micro-blogging service 10 hours a day, using it to connect with motoring experts and keep up on trends. "I don't need to go to bookstores or buy magazines," says Ye, 31, who lives in Xiamen, on China's east coast. "It saves me time and money."

Sina Weibo has become China's leading site for micro-blogging, the **Twitter**-inspired phenomenon focused on extremely short messages. The site is responsible for 87 percent of the time spent on micro-blogging services in China, says Eric Wen, an analyst at Mirae Asset Securities in Hong Kong.

In the lead-up to the 20th anniversary of the Tiananmen Square protests in June 2009, the Chinese government blocked Twitter. Shortly after, during ethnic riots in Xinjiang, **Facebook** went dark, too. The ensuing social media vacuum left an opening for Sina Weibo, which appeared in August of that year. Rivals such as **Tencent**, **Sohu**, and **NetEase** didn't begin rolling out their own micro-blogging services until early 2010. That gave Sina Weibo a head start, and it is now a top information source for many Chinese—and often an outlet for the controversial topics avoided by state-controlled media.

Weibo is a division of **Sina Corp.**, which operates China's third-most-visited Internet portal. Sina's shares, traded in the U.S. on the Nasdaq exchange, have almost tripled in price since Weibo's launch, and the company has a $5.7 billion market capitalization. Although Weibo does not yet make money, it is at the forefront of Sina Chief Executive Officer Charles Chao's effort to turn the company's sites into the premier destination for China's 450 million Internet users. He hopes Weibo's popularity will help Sina evolve from a **Yahoo!**-like portal that creates content internally to a Facebook-like site that attracts outside developers. "Our strategy is to build a platform that is open to everybody," he says.

Weibo mimics the format of Silicon Valley's micro-blogging pioneer. "We learned much from Twitter," says Chao. Weibo limits posts to 140 characters—though in Chinese, in which many words are just two or three characters, a lot more can be expressed under that constraint than in English. Weibo users follow and comment on updates from other members and can post photos and videos.

87%

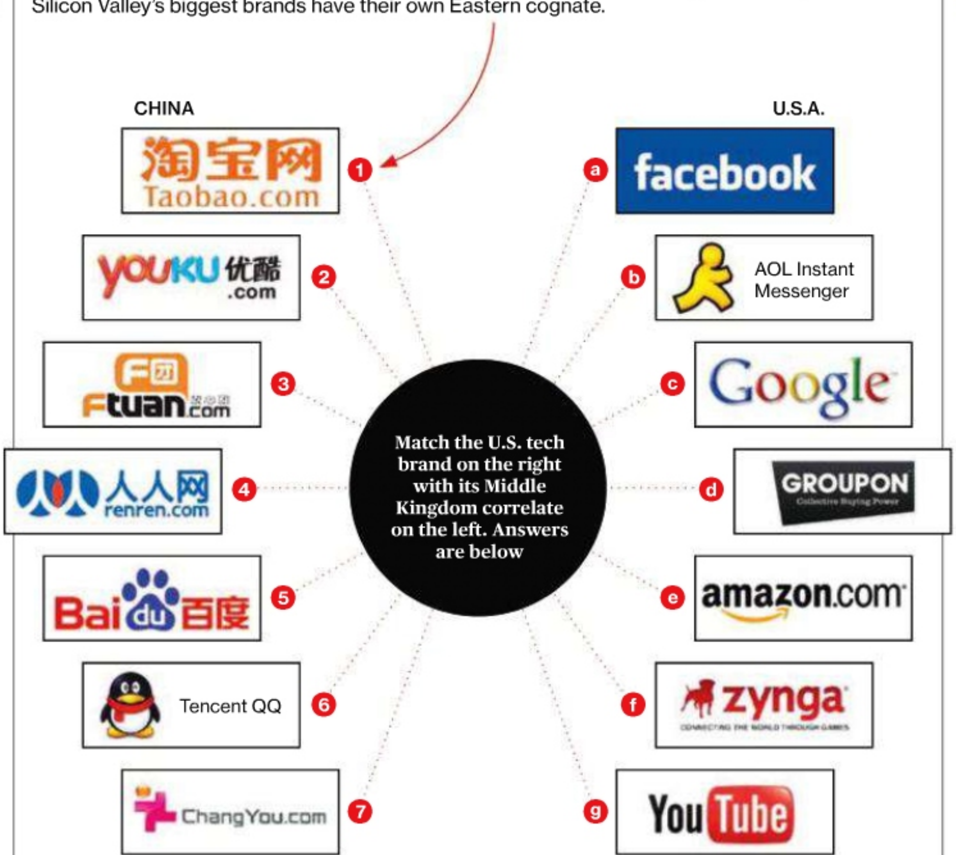
Weibo's share of total time spent on Twitter-like services in China

Celebrities are a big part of Weibo's appeal. The most popular accounts belong to entertainers such as actress Yao Chen, who has 5 million-plus followers. Just as "tweet" has become a verb in English, "*zhi weibo*"—literally "to knit a scarf"—has entered the lexicon in China. ("*Weibo*" means "micro-blog" but sounds like Mandarin for scarf.)

Like other Internet services in ➜

How do you say "Facebook" in Mandarin?

If imitation is the sincerest form of flattery, Chinese tech firms are downright adulatory. Most of Silicon Valley's biggest brands have their own Eastern cognate.



ANSWERS: 1. E, 2. G, 3. D, 4. A, 5. C, 6. B, 7. F

WorldMags

Technology

China, Weibo deletes or limits sensitive posts as required by the government. Nicholas Kristof, the *New York Times* columnist who often writes about human-rights issues in China and elsewhere, opened an account late last year. Kristof, who can write in Chinese, says censors deleted his account after five posts, one of which mentioned the 1989 Tiananmen Square crackdown. During the recent anti-Mubarak protests in Cairo, a search for "Egypt" returned only an explanation that legal restrictions prevented Weibo from displaying the results.

Despite censorship, Weibo is "by far the best platform for free speech" in China, says Lee Kai-fu, **Google**'s former China head and one of Sina Weibo's most popular users. Although the search term for Egypt was restricted, many Weibo posts mentioned the protests, and at least one account offered a live webcast from Tahrir Square.

Weibo users generally have the freedom to speculate about stories censored by the mainstream media. In December a village leader in the eastern coastal town of Yueqing was hit by a truck and killed. Users openly speculated that he had been murdered for speaking out against higher officials in a land dispute. Bill Bishop, an independent media analyst in Beijing, says Weibo poses challenges for censors yet provides a "real-time stream to all sorts of stuff going on around the country, and what people are thinking."

Weibo hasn't released user figures since October, when it had 50 million members, but analysts at investment firm Susequehanna International predict it will have 120 million members by 2012. Twitter had 175 million as of September. Says Ma Yuan, an analyst with investment bank Bocom International Holdings in Beijing: Weibo "is becoming the next killer application on the Internet and mobile phones."
—*Wenxin Fan*

The bottom line *Sina's CEO says micro-blogging service Weibo is key to the company's goal of becoming a dominant Internet platform.*

Quoted



"It did make me appreciate the human brain. The protein and salt and whatever. ... That little bit of tissue could hang in there with a billion-dollar supercomputer."
—*Jeopardy!* contestant Ken Jennings, who lost a match against IBM's Watson on Jan. 14-16

New Media

Will 'TiVos for Reading' Save Old Media?



▸ **Apps let Web users save articles for reading when it's convenient**

▸ **Leaving "clicks and page views to the Gawkers and HuffPosts"**

For media traditionalists, recent events have proved rather disheartening. **Demand Media**, a five-year-old so-called content farm that churns out instructional videos such as "How to Save Money on a Date," went public in late January and is now worth $240 million more than the **New York Times Co. The Huffington Post**, a six-year-old digest of quick hits and strong views, many by unpaid bloggers, was recently purchased by **AOL** for $315 million. Meanwhile, circulation numbers for print publications are generally down, and the monthly audiences at websites such as the gossip blog **Gawker** are broadly up. It's more evidence, in case anyone needed it, that we're living in a media culture defined by appetizer-size articles and hastily assembled content, all tailored for discoverability by search engines.

But don't write the obituary for long-attention-span journalism quite yet. Go to instapaper.com and download the plug-in for your Web browser. Then install the accompanying **Instapaper** application to your iPhone, iPad, Kindle, or (soon) Android device. The next time the boss steps away and your midafternoon Web excavation unearths a well researched, brilliantly written article—such as the feature stories in this magazine, if we may be so bold—click "read later" in the browser toolbar. The service acts like a TiVo for words. It will save the story to your e-reader or your tablet so it can be read later on the train, the couch, or wherever you settle in to really read. "We let you save stories for a time when you can actually attentively read them," says Marco Arment, the creator and sole employee of Instapaper. "You can leave the world of clicks and page views to the Gawkers and HuffPosts." He charges $5 for a premium version of the app that lets users store up to 250 articles and share them with other users.

Instapaper, which has more than a million users and is growing rapidly, has competition. The biggest is **Read It Later**, with more than 3 million users. **Longreads**, a site that shares recommendations for in-depth articles, has a lively **Twitter** feed with more than 15,000 followers. Magazines such as *Wired*, *The Atlantic*, and *The New Yorker* have started to specify their stories as Longreads when they promote them on Twitter. "We are trying to help filter out the noise and junk content on the Web," says Mark Armstrong, who started Longreads a little over a year ago.

Nate Weiner, the 26-year-old Web designer in San Francisco who created Read It Later, thinks these services hold promise for old-school journalism. Young people who may have canceled a subscription to a magazine or newspaper—or never had one to begin with—tend to stumble onto serious writing while they're online at work. That's precisely when they're least likely to plow through a longer story. Weiner recently sifted Read It Later's usage data and found that most of his users read saved stories between 6 p.m. and 9 p.m. If they're on mobile devices, reading time spikes during the commuting hours and again from 8 p.m. to 10 p.m. "When I saw this

CORBIS CUSP/ALAMY (NEWSPAPER); SETH WENIG/AP PHOTO

WorldMags

Rethink Possible®

iPhone 3GS now only $49

Cue the applause app.



FREE SHIPPING | 1.866.MOBILITY – ATT.COM/iPHONE – VISIT A STORE

Limited-time offer. While supplies last. Requires new 2-year wireless voice agreement of $39.99 or higher with min. 15/mo. DataPlus plan. Subject to wireless customer agrmt. Credit approval req'd. Activ. fee up to $36/line. Coverage & svcs, including mobile broadband, not avail everywhere. Geographic, usage & other conditions & restrictions (that may result in svc termination) apply. Taxes & other chrgs apply. Prices & equip. vary by mkt & may not be avail. from ind. retailers. See store or visit att.com for details and coverage map. **Early Termination Fee (ETF):** None if cancelled during first 30 days, but a $35 restocking fee may apply; after 30 days, ETF up to $325 applies depending on device (details att.com/equipmentETF). Subject to change. Agents may impose add'l fees. **Regulatory Cost Recovery Charge** up to $1.25/mo. is chrg'd to help defray costs of complying with gov't obligations & chrgs on AT&T & is not a tax or gov't req'd chrg. Screen images simulated. ©2011 AT&T Intellectual Property. All rights reserved. Apple, the Apple logo, and iPhone are trademarks of Apple Inc., registered in the U.S. and other countries.

data, it made me hopeful," says Weiner. "The iPad and iPhone and other mobile devices are allowing us to move media to a time when we can actually consume it."

There may be one snag for traditional publishers. Services such as Instapaper and Read It Later let users view their saved stories in an uncluttered format stripped of the ads and other marginalia of the Web browser. That could cost media companies some advertising revenue. "The general sense I get from publishers is that they are more interested in getting people to read their articles and see their brand than getting the tiny bit of revenue they might be losing here," says Mike Vorhaus, president of media consulting firm Magid Advisors. It's possible that tools such as Instapaper and Read It Later simply aren't popular enough yet to pose a threat to publishers. Or maybe the folks at those old-time media companies finally see a place for long-form content in a short-form world. —*Brad Stone*

The bottom line *Instapaper and other apps that save articles for later consumption are a hit with online readers—and with old-school publishers.*

100

MILLION DOLLARS

Amount Internet radio site Pandora hopes to raise in an IPO announced on Feb. 11. The company lost $328,000 on revenue of $90.1 million in the first nine months of 2010.

DATA: PANDORA MEDIA



Mumbai: New 3G service will give millions high-speed access to the Net

FROM LEFT: KUNI TAKAHASHI/THE NEW YORK TIMES/REDUX; PHOTOGRAPH BY TIMOTHY ARCHIBALD FOR BLOOMBERG BUSINESSWEEK

Mobile

After Years of Delays, India Finally Gets 3G

- Service starts just as the rest of Asia rolls out 4G wireless service
- "People have been starved for high-speed Internet connections"

In 2007, Varun Nand Chahal, a young entrepreneur in Bangalore, bought a 3G-ready mobile phone. It was his first handset capable of high-speed Internet access, and he was looking forward to using it to surf the Web. The only problem was that India didn't have 3G. The launch of the service in the country was repeatedly delayed. Just recently, Chahal, 25, got his wish. After three and a half years of waiting—and just in time for the rest of Asia to move on to 4G—Indian wireless carriers are rolling out 3G. **Tata Teleservices** began offering 3G in November, and **Bharti Airtel**, India's largest operator, launched service in the southern states of Karnataka and Tamil Nadu in January. **Vodafone Essar** and other carriers plan to introduce 3G, too. How's the quality? "Sometimes I get a signal," says Chahal, a Bharti Airtel customer. "Sometimes I don't."

Japan and South Korea got 3G early last decade, and China has had it since 2009. In India, bureaucracy stalled the process. The government didn't auction off licenses for the segments of electromagnetic spectrum that 3G uses until last year. Then, companies that spent a combined $14.9 billion in those auctions had difficulty building up their networks: Regulators banned operators from buying equipment from low-cost Chinese suppliers such as **Huawei** and **ZTE** for nine months until the vendors agreed to satisfy security concerns by providing access to their source code.

Another hurdle: The country is divided by telecom authorities into several dozen areas, with five or six operators getting permission to work in each—and none getting the go-ahead to operate nationwide. Since no one company has a nationwide 3G network, wireless carriers need to form alliances with rivals and provide roaming services domestically.

For all the hiccups, though, the new 3G networks offer the potential to transform India. Less than 1 percent of the population has access to broadband connections, says Aditya Kaul, an analyst with ABI Research in London, because the quality of fixed-line networks is so poor. "You don't have the infrastructure, so you have to look at other means of providing broadband," he says. While the networks that operators are launching won't be powerful enough to stream movies or provide other data-intensive services, they will still open the Internet to many Indians who "are just looking for basic broadband connectivity," adds Kaul. "Wireless is a good, cost-effective way to do that. That's why people are so excited." Mobile operators are already introduc-

WorldMags

ing services unheard of in pre-3G India. Vodafone Essar announced an alliance with **ICICI Ban**k on Jan. 12 to provide mobile banking services. The same day, Bharti Airtel unveiled a similar partnership with the State Bank of India. India is on the cusp of a "new wave of Internet access," Bharti Airtel Chief Executive Officer Sanjay Kapoor told analysts on Feb. 2.

India's telecom companies need the boost. A dramatic price war has cut into their revenues for voice and text-messaging services over 2G networks. Bharti's average revenue per user, a benchmark figure for analysts, is just 198 rupees ($4.38) a month, down from 230 rupees a year ago. Executives at Indian operators say they learned their lesson from 2G and won't let the same price war happen again. The 3G battles will be fought not on price "but on content and quality," Syed Safawi, president of No. 2 carrier **Reliance Communications**, told reporters in December. Skeptics such as ABI's Kaul aren't convinced Indian operators can resist the temptation to undercut rivals. "To compete in the market, the best strategy is to go with the lower price," he says.

Even if a price war does break out, cheaper access will make it easier for more Indians to use mobile networks as their primary way onto the Internet. "People have been starved for high-speed Internet connections," says G.V. Giri, an analyst in Mumbai with IIFL Securities, who predicts the number of people with broadband access will grow from 10 million now to 100 million by 2014. Those customers may eventually get to enjoy the same Internet speeds as some of their earlier-adopting Asian neighbors: Several Indian carriers are talking about launching 4G networks, perhaps as early as next year.

Indian subscribers may not have much experience with high-speed access, but that won't be a problem as long as they have phones that can get them online. "You just need to get the things in their hands," Giri says. "The rest, they'll take care of."

—*Bruce Einhorn with Ketaki Gokhale*

The bottom line *Indian wireless carriers, ravaged by years of price wars, are rolling out 3G. This time, they say, they'll compete on content and quality.*

Innovator

Adam Beguelin



The entrepreneur has built a free service that makes it easy to share and store video feeds and turns cheap webcams into motion detectors

In 2006, Adam Beguelin sold his start-up, a video-search site called Truveo, to AOL for $50 million. Then he decided to pack up his family and move to Vietnam for a year of kite-surfing and cultural exploration. He didn't want to wait around for his place in California to sell, so before he left he rigged two webcams to monitor the open houses.

The difficulties of getting that setup to work gave Beguelin, 47, the idea for his next venture. He's now back in the U.S. and working on Sensr.net, a site that makes it easy to view, share, and store video feeds from network cameras, which connect to the Internet without need for a PC. (Some webcams, including those packaged with new laptops, require additional software.) Sensr lets you monitor video from such cameras using any Internet-connected device. Sensr also applies its motion-detection algorithms to each feed, turning even the cheapest webcam into a surveillance device. If a camera is aimed at, say, the front door, Sensr recognizes when a visitor–or a burglar–opens it and can send a text-message alert to the homeowner. The site stores an unlimited amount of low-quality video and for a small monthly fee will start keeping high-definition feeds later this year.

Beguelin says his service, which will also make it easy to share videos on YouTube, Facebook, and Twitter, is "about socializing these devices." Just as Facebook has become the hub for online identities, he hopes Sensr will become the hub for Web-connected cameras everywhere. He hopes cafés and restaurants will set up cameras so that customers can log on to Sensr, search for their local hot spot, and see how long the line is before leaving home. Ketan Kothari, an entrepreneur in Palo Alto, Calif., who heads to India during the Bay Area's rainy winter months, says he uses the service to monitor his flood-prone basement and arrange cleanups from abroad.

Sensr is "more for early adopters" at this point, says John Honovich, founder of IP Video Market Info. Internet services that focus on webcam features are still at a "very early market stage." Sensr, based in Incline Village, Nev., received $1.5 million in venture capital funding in January.

Before turning to entrepreneurship, Beguelin taught computer science at Carnegie Mellon and co-founded its Silicon Valley campus. The sabbatical in Vietnam was not just a way to decompress but also a chance to help "our kids to understand their heritage," says Beguelin, whose wife is from Vietnam. He's now exchanged his kite-surfing gear for what he says is "a lot" of cameras all over his home. "For a while, I was trying to catch a rat under the house," he says. "I had a night-vision camera so I could check the traps." —*Olga Kharif*

Payday ▶ **Sold video-search site Truveo to AOL for $50 million in 2006**

Hobby ▶ **Learned to kite-surf during a yearlong sabbatical in Vietnam**

Venture ▶ **Sensr.net shares, stores, and helps monitor webcam video**

WorldMags



BLACKROCK

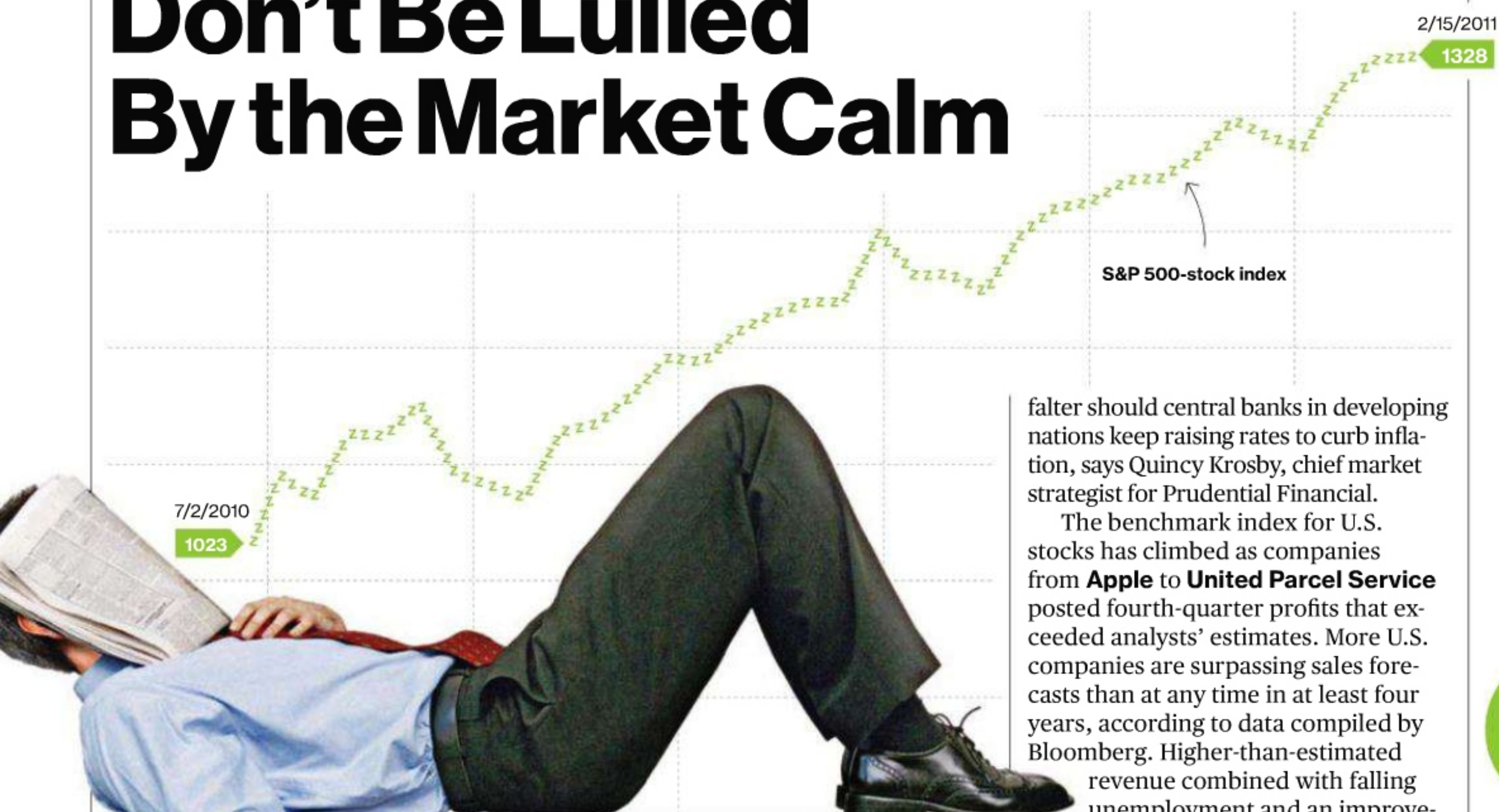
Call 1-800-iShares to request a prospectus, which includes investment objectives, risks, fees, expenses and other information that you should read and consider carefully before investing. Investing involves risk, including possible loss of principal. There can be no assurance that an active trading market for shares of an ETF will develop or be maintained. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Securities focusing on a single country may be subject to higher volatility. The iShares Funds are distributed by SEI Investments Distribution Co. ("SEI") and advised by BlackRock Fund Advisors ("BFA"). BFA is a subsidiary of BlackRock Institutional Trust Company, N.A. ("BlackRock"), neither of which is affiliated with SEI. The iShares Funds are not sponsored, endorsed, issued, sold or promoted by MSCI Inc., nor does this company make any representation regarding the advisability of investing in the Funds. Neither SEI, nor BlackRock Institutional Trust Company, N.A., nor any of their affiliates, are affiliated with the company listed above. ©2011 BlackRock Institutional Trust Company, N.A. All rights reserved. iShares* is a registered trademark of BlackRock Institutional Trust Company, N.A. All other trademarks, servicemarks or registered trademarks are the property of their respective owners. iS-4114-0211. Source: Bloomberg and BlackRock, as of 12/31/2010.

WorldMags

WorldMags

Contents ▶ Studying SAC's trading pattern 46 ▶ The NYSE: From the buttonwood tree to bits 46 ▶ A milder option ARM meltdown 47
▶ Barclays builds M&A muscle 49 ▶ Bid & Ask: Sanofi-Aventis's $20.1 billion Genzyme coup 50 ● Edited by Eric Gelman

Don't Be Lulled By the Market Calm



OCEAN/CORBIS

▶ Stocks haven't risen so fast and smoothly since 1971

▶ "You want to see a pullback, and it'll be healthy"

If you've been checking your portfolio regularly, you may have noticed something peculiar: Week after week, the market has been moving up without major setbacks. The Standard & Poor's 500-stock index soared 30 percent from July 2 to Feb. 15, falling 1 percent or more on only 13 occasions during that time. Based on one measure of volatility, stocks haven't risen this much amid price swings this narrow since 1971.

Don't get complacent. While many investors expect the rally to continue, analysts say the calm can't last and may be a sign of a coming pullback. "It is unusual to have such a slow grind higher," says Walter Todd, who helps manage about $900 million at Greenwood Capital Associates in Greenwood, S.C.

The Federal Reserve's $600 billion program of buying Treasuries has boosted confidence in the U.S. economy, which grew more rapidly in the fourth quarter. The decline in volatility that has accompanied the good news puts equities at risk for short-term losses should events challenge investors' optimism.

The S&P 500 had its biggest drop in more than five months on Jan. 28, falling 1.8 percent, as protests in Egypt intensified. While the market bounced back quickly, overseas political uprisings might cause the U.S. gauge to decline again, says Scott O'Neil, a money manager with O'Neil Data Systems and president of MarketSmith, a research firm based in Los Angeles. Stocks could also falter should central banks in developing nations keep raising rates to curb inflation, says Quincy Krosby, chief market strategist for Prudential Financial.

The decline in volatility in the past eight months suggests that equities are at risk for short-term losses

The benchmark index for U.S. stocks has climbed as companies from **Apple** to **United Parcel Service** posted fourth-quarter profits that exceeded analysts' estimates. More U.S. companies are surpassing sales forecasts than at any time in at least four years, according to data compiled by Bloomberg. Higher-than-estimated revenue combined with falling unemployment and an improvement in manufacturing signal that the economic recovery is picking up.

Money managers also are more bullish on global stocks this month than they have been in a decade, according to a Bank of America poll. The survey showed that 67 percent of respondents, who together manage $569 billion, had an "overweight" position on global equities, the highest level since the survey began in April 2001. That compares with 55 percent in January and 40 percent in December.

Too much optimism can be a bad sign for stocks, as a look at volatility statistics shows. The S&P 500's ride upward has been accompanied by a 69 percent drop in an options-market indicator known as 30-day realized volatility, which fell to 9.996 on Feb. 15 from last year's peak of 32.53 on June 10, Bloomberg data show. During the financial crisis, the gauge soared to 82.21 in November 2008, the highest level since the October 1987 stock market crash.

When 30-day volatility slips below 10 and stays there at least three days, the S&P 500 rises 0.3 percent in the next month, on average. That's half the average monthly advance

WorldMags

WorldMags

shown in Bloomberg data going back to 1962. The volatility measure slipped to 7.94 in March 1994, and the S&P index dropped 6.1 percent in the next month. Longer-term, though, the market recovers after that kind of volatility decrease. Over the course of a year following a slump in realized volatility to 10 or lower, the stock index rises 9.2 percent, vs. the 7.4 percent average, Bloomberg data show.

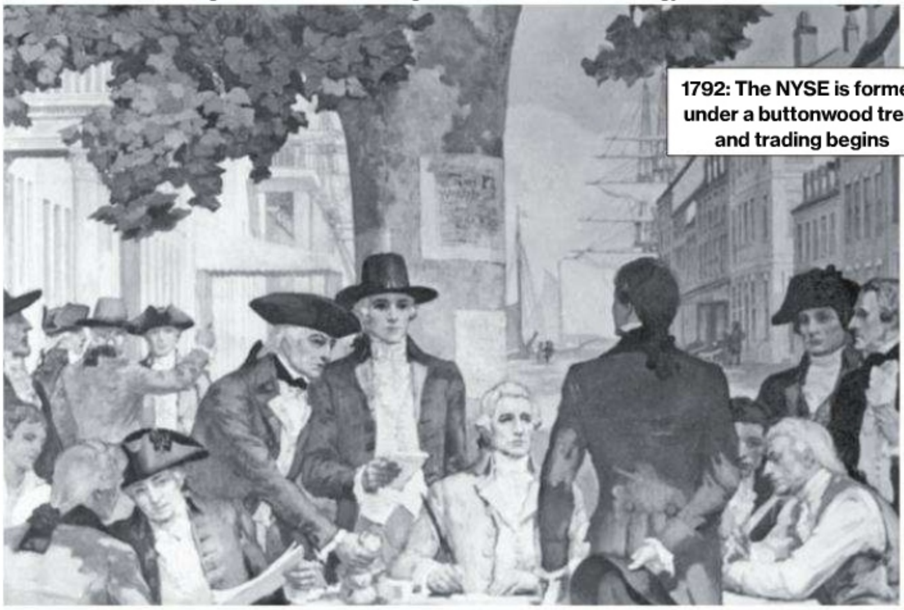
A short-term drop in the market might actually help spur gains over the long haul, says Prudential's Krosby. "Without a pullback, investors are going to be leery of going in because they suspect it will drop," she says. "You want to see a pullback, and it'll be healthy because it can allow the market to move up in a more meaningful way."

David Kelly, who helps oversee $450 billion as chief market strategist at JPMorgan Funds, says the lack of volatility may encourage investors to put more money into the market, which is what they should do. "Stocks are cheap," he says, "and for most long-term investors, the thing they would do is bet on the tide rather than play the waves."
—*Whitney Kisling and Jeff Kearns*

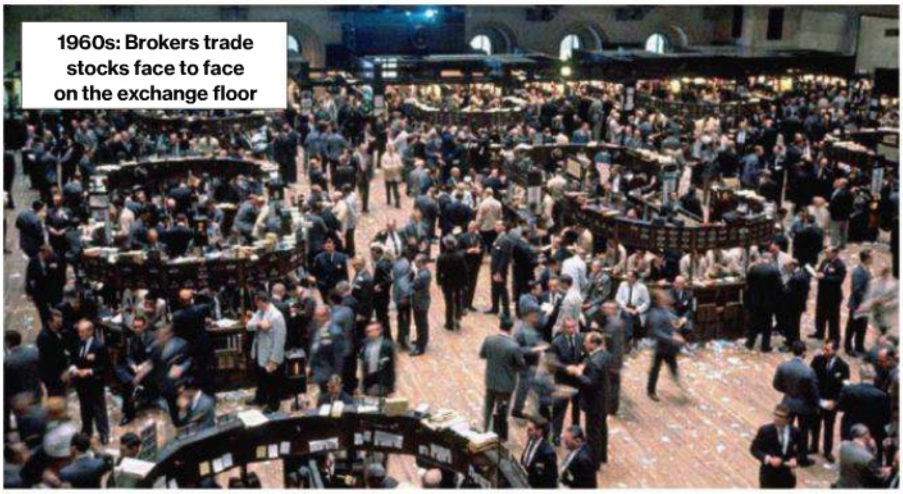
The bottom line *The low level of volatility the market has seen recently has often heralded periods of subpar returns.*

From the Buttonwood Tree to Bits

Deutsche Börse's $9.5 billion purchase of New York Stock Exchange parent NYSE Euronext will create the world's largest owner of equities and derivatives markets. Global stock exchanges are consolidating to drive down technology costs.



1792: The NYSE is formed under a buttonwood tree, and trading begins



1960s: Brokers trade stocks face to face on the exchange floor



2010: Almost all trading is electronic. Exchange membership is down by half since 2000

Investigations

A Hedge Fund's Moves Mimic Insider Dealings

- **SAC's buying and selling parallel some trades based on tips**
- **The trades "are consistent with patterns" the feds are examining**

Three days before **Blackstone Group** announced its 2007 buyout of Hilton Hotels, billionaire Steven A. Cohen's hedge fund, **SAC Capital Advisors,** reported almost tripling its stake in the hotelier from the previous quarter. The stock soared 26 percent on the trading day following the July 3 announcement.

Federal prosecutors allege that a purchase of Hilton shares by another hedge fund manager, **Galleon Group** co-founder Raj Rajaratnam, on the day the deal became public was based on

WorldMags

WorldMags

an illegal insider tip. SAC's investment in Hilton, disclosed by the firm in a routine Securities and Exchange Commission filing, is one of at least 11 instances from 2006 through 2009 in which the Stamford (Conn.) hedge fund traded stocks near the time of what prosecutors say was insider trading in the same shares by other hedge funds, according to data compiled by Bloomberg.

Rajaratnam is awaiting trial in March after pleading not guilty to a 19-count U.S. indictment alleging securities fraud. Since October 2009, more than three dozen people, including Rajaratnam and former SAC employees, have been charged in three overlapping insider-trading schemes. They involve Rajaratnam, former employees of Galleon, and consultants who link investors with industry experts working at publicly traded companies. About two dozen people have pleaded guilty.

Prosecutors subpoenaed SAC in November as part of the probe. Authorities haven't accused SAC or any current employee of wrongdoing. Jonathan Gasthalter, an SAC spokesman, declined to discuss the firm's stock positions. He says the firm is cooperating with investigators.

At Bloomberg's request, Houman Shadab, an associate professor at New York Law School, reviewed SEC filings detailing SAC's holdings in stocks that federal prosecutors have identified as subjects of insider leaks. The filings are quarterly snapshots of positions at the $12.8 billion hedge fund that may change daily or hourly. While the filings don't show purchase or sale dates or whether any trading was profitable, Shadab found that the hedge fund's positions in the stocks moved up or down in a manner consistent with buying and selling that federal prosecutors have described as based on leaks of material, nonpublic information in insider-trading cases.

"While the trades by themselves don't prove insider trading or fraud, they are consistent with patterns federal investigators are examining based on trading of nonpublic information," Shadab says. He has testified before a congressional panel on the role of traders in the financial crisis and writes books on hedge fund regulation.

The filings show that SAC held 1.2 million Hilton shares on June 30,



Cohen's firm says it is cooperating with investigators

2007, nearly triple its holdings of 436,000 three months earlier. Blackstone said after the close of trading in New York on July 3 that it would buy Hilton, setting up the price jump on July 5 after the Independence Day holiday.

U.S. prosecutors accuse Rajaratnam of receiving an illegal tip on the deal "in or about late June early July 2007," according to criminal case records. Federal authorities allege that Rajaratnam arranged for Galleon to purchase 400,000 Hilton shares on July 3, in the hours before the deal became public.

SAC securities filings from 2006 through 2009 also show position changes in at least 10 other stocks during periods when prosecutors have said Rajaratnam and others were trading based on insider tips. The stocks are Akamai Technologies, Atheros Communications, ATI Technologies, Clearwire, eBay, Google, Intel, Advanced Micro Devices, Marvell Technology, and Polycom.

In the same New York courtroom where Rajaratnam will go on trial, Cohen is being sued by his former wife, Patricia, in a civil lawsuit that alleges she is owed money from the couple's 1990 divorce settlement. In that complaint, Patricia Cohen alleges that the SAC founder has profited in the past on insider information.

Her former husband gained $10 million in early 1986 on a tip that **General Electric** would acquire RCA, according to the complaint. Steven Cohen invoked his Fifth Amendment right under the U.S. Constitution not to incriminate himself during sworn testimony to the SEC on the GE-RCA deal in June 1986, the lawsuit says. Patricia Cohen received a transcript of Steven Cohen's deposition in response to a request under the Freedom of Information Act, she says in the suit. SAC spokesman Gasthalter says Patricia Cohen's lawsuit is without merit. The SEC didn't sue Cohen.

In early February, the insider-trading investigation ensnared two former SAC portfolio managers. Noah Freeman and Donald Longueuil obtained material, nonpublic information on two of the 11 stocks, AMD and Marvell, in a conspiracy that began before they joined SAC in 2008, according to a lawsuit by the SEC. The agency accuses Longueuil of trading Marvell shares in May 2008 based on an illegal tip from Freeman. SAC hired Freeman that June and Longueuil that July.

The men, both 34, were among four people named in criminal complaints filed on Feb. 7 by the Justice Dept. Freeman's lawyer, Benjamin Rosenberg, declined to comment. Longueuil's attorney, Craig Carpenito of Alston & Bird, didn't respond to a request for comment.

In a Feb. 8 statement, SAC said it was "outraged" by the alleged "egregious violations of our ethical standards" by Freeman and Longueuil, who left SAC in 2010 "due to poor performance." The government alleged that their illegal conduct took place between 2006 and 2010. —*Elliot Blair Smith*

The bottom line *SEC filings show that SAC Capital moved in and out of some stocks near the time of alleged insider trading in the shares.*

Housing

Forecast: A Milder Mortgage Meltdown

▶ Low interest rates have helped defuse the option ARM time bomb

▶ "It's not at all what people anticipated"

This is the year thousands of homeowners with option adjustable-rate mortgages were supposed to default as their payments spiked. "Everyone identified option ARMs as a potential time bomb," says Guy Cecala, publisher of newsletter *Inside Mortgage Finance*. Low interest rates and a surge of early defaults mean the numbers probably won't be as bad as forecast, softening the blow to the housing market, where prices have resumed falling.

Introduced in the early 1980s, the option ARM gives borrowers a choice during an initial period, usually five years, of paying principal and interest, interest-only, or a minimum outlay covering only a portion of the interest. The loans gained popular-

OPPOSITE PAGE, FROM TOP: BETTMANN/CORBIS; ROGER WOOD/CORBIS; JIN LEE/BLOOMBERG; THIS PAGE: REUTERS/CORBIS

WorldMags

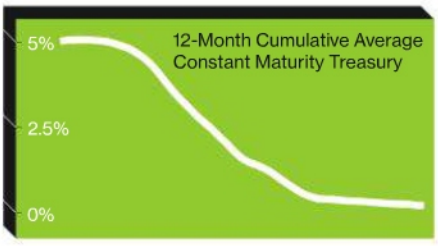
ity as housing prices soared in the past decade because the low initial payments allowed borrowers to qualify for homes they couldn't otherwise afford.

Many borrowers defaulted because they couldn't keep up with even the minimum payments or walked away because declining prices made their homes worth less than what they owed on them. Borrowers who chose to pay less than the full interest due saw the shortfall added to the principal. The problem with that approach is that the loans can reset sooner if a homeowner's balance reaches certain levels, usually 110 percent or 125 percent of the original amount. As a result, some borrowers saw their payments jump well before five years. "It's not that option ARMs weren't a bad way to finance homes," says George McCarthy, a housing economist at the Ford Foundation in New York. "It's just that the disaster already happened."

About $600 billion of the loans were made from 2005 through 2007, according to *Inside Mortgage Finance*. Lenders have revised terms on about 20 percent of option ARMs, sometimes switching them to a fixed rate, says Michael Fratantoni, vice-president for research at the Mortgage Bankers Assn. in Washington. Many more loans have disappeared through payoffs, refinancing, foreclosures, or sales in which the lender took less than the amount owed. About half of the loans issued from 2003 to 2007 remain outstanding, Fratantoni says.

Borrowers' Relief

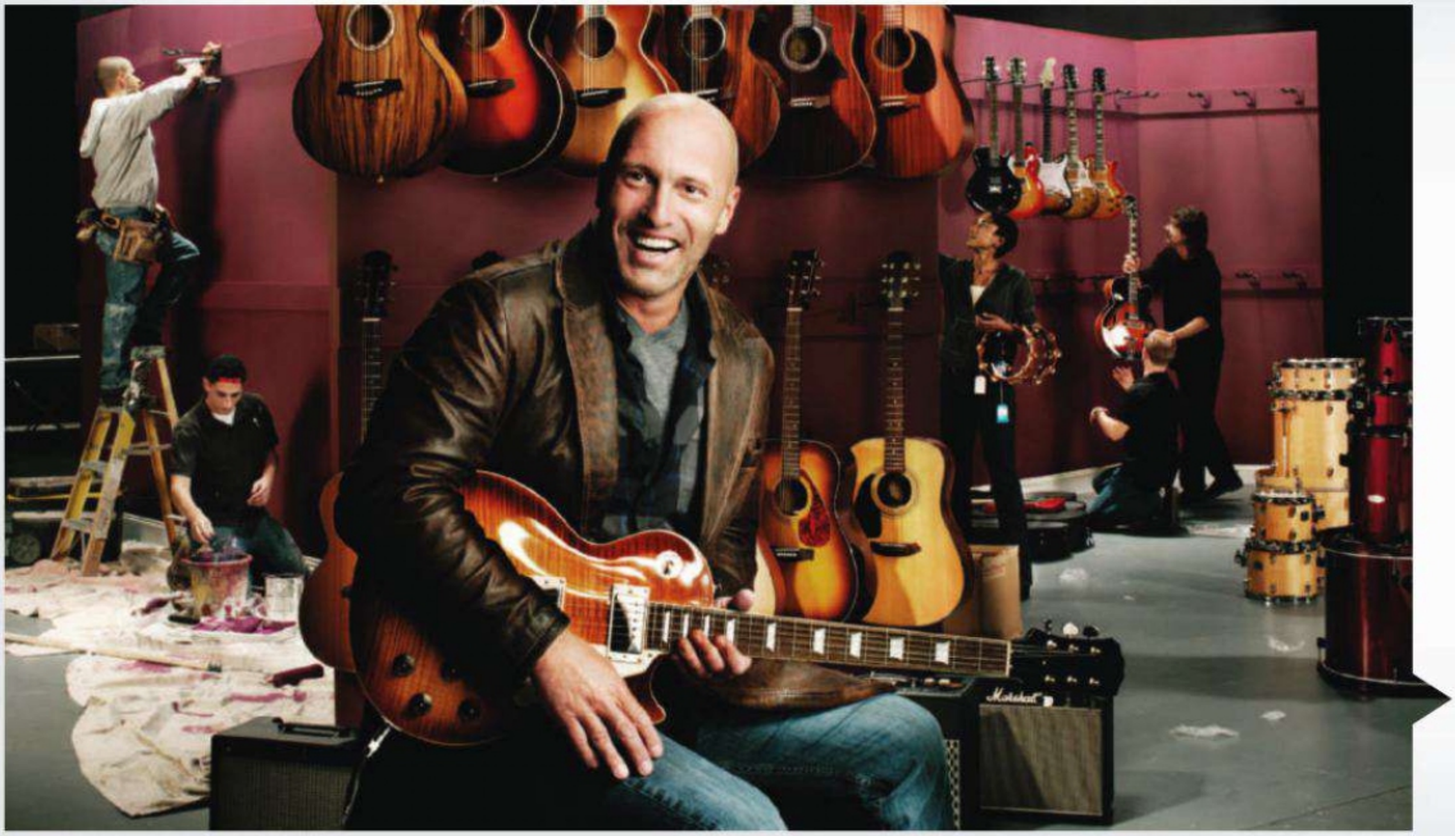
An index used to set option ARM rates has plunged



DATA: BLOOMBERG

For those homeowners who are still holding option ARMs, continuing low interest rates will cushion the impact of resets. An index tied to one-year Treasury yields commonly used as a benchmark to set interest rates on option ARMs stands at 0.29 percent. That is down from almost 5 percent at the beginning of 2007, according to data compiled by Bloomberg. The average borrower's monthly payments will increase 30 percent to 40 percent, Barclays Capital estimated in a Jan. 7 report. Analysts a few years ago were forecasting that payments for some borrowers could double. "Of the borrowers who are still paying, the recast will not be a big deal," Fratantoni says. "It's not at all what people anticipated."

The prospect of fewer defaults is a plus for the housing market, which was burdened by 2.2 million foreclosed homes as of Dec. 31, according to data from Lender Processing Services in Jacksonville, Fla. The S&P/Case-Shiller index of home values in 20 cities



WorldMags



Being there without being there page 52 ▶

fell 1.6 percent in November from the year before, the biggest decrease since December 2009, the group said on Jan. 25. The gauge remains 30 percent below its 2006 high.

Yet the option ARM problem is far from over. A model developed by JPMorgan Chase analysts predicts that 70 percent of remaining option-ARM loans that were bundled into bonds will eventually default. And a sudden increase in rates could trigger a new round of defaults. "Lots of lenders have taken action to stave it off, knowing it's a problem," says Jon D. Maddux, chief executive officer of You-WalkAway.com in Carlsbad, Calif., which advises borrowers on strategic defaults. "They have extra time because rates are low. But when those rates go up, that's when we're going to see this problem happen."

—*Prashant Gopal and Jody Shenn*

The bottom line *The wave of defaults on option ARMs expected to slam the housing market this year may be less damaging than once feared.*

PHOTOGRAPH BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

Investment Banking

Building on Lehman, Barclays Rises in M&A

▶ **The ability to provide financing helps the bank get in on deals**

▶ **They're "taking Goldman on in hand-to-hand combat"**

The future looked bleak for Paul Parker, Lehman Brothers' co-head of mergers and acquisitions, as he helped negotiate the sale of the bank's North American operations to **Barclays** over the course of two hectic days in September 2008. Explaining Lehman's collapse to his family "was my low point, personally," he recalls. Two and a half years later, that deal has helped put **Barclays Capital**, the investment banking division of Barclays, in a position to challenge **Goldman Sachs** for the mergers and acquisitions crown. And Parker, 47, now global head of M&A at Barclays Capital, has a different view of Lehman's forced sale: "I truly believe it will be the most successful financial-services combination ever."

Barclays finished second only to Goldman in advising on U.S. takeovers announced in 2010, according to data compiled by Bloomberg. The ranking is based on deals in which Barclays advised a U.S. takeover target or a U.S. company buying another U.S. company. (Neither Barclays nor Lehman finished that high in the rankings before the deal.) This year, Barclays has already worked on $33.6 billion in such deals, advising **Qualcomm** on its $3.2 billion purchase of **Atheros Communications** and **Progress Energy** on its sale to **Duke Energy** for $13.7 billion. Says Simon Maughan, co-head of European equities at MF Global in London: "They are the one firm that's prepared to say, 'We're taking Goldman on in hand-to-hand combat.'" On Feb. 15, Barclays Capital reported that revenue from advisory and debt and equity under-

Booming is
turning an early pay discount into more space for music.



Jon Haber, owner of Alto Music, was one of the very first owners to receive a Plum Card from American Express OPEN. During the recession, Jon used his Card to buy as much inventory as possible. And with the savings he got from the 1.5% early pay discount on those purchases, Jon was able to expand his business at a time when others were closing their doors.

1.5% EARLY PAY DISCOUNT *or* DEFER PAY OPTION

1-888-OPEN-PLUM | OPEN.COM/PLUM

JON HABER
ALTO MUSIC
ALTOMUSIC.COM
MEMBER SINCE 07

Start Booming.
AMERICAN EXPRESS OPEN

Pay the balance in full within 10 days of the statement closing date and get a 1.5% discount on virtually all purchases made that month. The discount will appear as a credit on the following billing statement. Pay 10% of the balance from new activity on your billing statement, plus the entire amount of any previously deferred payment or amounts past due by the "Please Pay By" date on that statement, and you can extend payment on the rest until the closing date of your next billing cycle, without penalty. Visit open.com/plum for details. ©2011 American Express Bank, FSB. All rights reserved.

WorldMags

WorldMags

writing increased 3 percent in 2010, to £2.2 billion ($3.5 billion).

The key to the bank's rise in the rankings is the combination of Lehman's connections to U.S. corporations and the ability of Barclays, Britain's third-largest bank by market value, to finance deals. Lending power has been especially useful in getting a role in leveraged buyouts, which are heavily dependent on debt. Barclays advised investment firm **3G Capital** on the $3.3 billion takeover of **Burger King** announced in September. "We are doing things now that neither firm could have aspired to alone," says Jerry del Missier, co-CEO of Barclays Capital.

Not all deals have gone smoothly. On Feb. 14 a Delaware judge postponed a **Del Monte Foods** shareholder vote on the company's sale to a group led by **KKR** after investors sued. The plaintiffs' lawyer says that Barclays, which is advising on and helping finance the deal, "undermined any competitive bidding process." Barclays disputes the accusation, saying it approached 53 potential buyers for Del Monte.

Barclays retained some key Lehman bankers, including Gary Posternack, head of M&A for the Americas, who specializes on energy deals. And it has spent money to lure M&A stars, including Richard Landgarten from Moelis to be co-head of its global health-care group. Skip McGee, Barclays's head of investment banking, says his firm's focus this year is to increase its deal activity in financials and industrials, where the firm ranked sixth and fifth, respectively, in the U.S. last year, Bloomberg data show.

Success attracts attention from rivals, and Barclays Capital may have to fend off personnel raids from banks such as **Citigroup** that are trying to strengthen their M&A units. Despite the strong results, Barclays says it reduced 2010 bonuses for Barclays Capital employees by an average of about 12 percent. That came after Chancellor of the Exchequer George Osborne announced that Britain's biggest banks had agreed to pay lower bonuses and increase lending. Parker says he will fight to keep his people. "We won't be complacent on that," he says. "We will be competitive." Ⓑ —*Jeffrey McCracken with Laura Marcinek*

The bottom line *Aided by Barclays's ability to finance deals, Barclays Capital is winning advisory roles in more U.S. mergers and acquisitions.*

Bid & Ask

by Cristina Lindblad



1. **Sanofi-Aventis**, France's biggest drugmaker, agreed to buy Genzyme for at least $20.1 billion, ending its nine-month pursuit of the U.S. biotech company.

2. **Deutsche Börse,** operator of the Frankfurt exchange, is buying New York Stock Exchange parent NYSE Euronext for $9.5 billion.

3. A judge in Ecuador ordered **Chevron** to pay $8.6 billion plus an equal amount in punitive damages for environmental harm to the Amazon rainforest. The company says it will appeal.

4. The Russian government garnered $3.3 billion from the sale of a 10 percent stake in No. 2 lender **VTB Group**, kicking off a new round of privatizations aimed at raising $34 billion.

5. Private equity firm Clayton, Dubilier & Rice acquired **Emergency Medical Services**, the largest U.S. operator of ambulance services, in a leveraged buyout valued at about $3.2 billion.

6. **General Electric** paid $2.8 billion for a unit of John Wood Group that makes equipment to extract oil and gas from mature fields. The business also helps extract gas from shale.

7. In its second deal of the month, **EchoStar,** a provider of satellite TV services, is acquiring rival Hughes Communications for about $1.3 billion.

8. Brazilian billionaire Eike Batista's **AUX Canada Acquisition** reached a verbal agreement to buy the 80 percent of gold explorer Ventana Gold that it does not own, for about $1.2 billion.

9. **Pandora Media,** an Internet radio service with more than 80 million users, plans to raise as much as $100 million in an initial public offering.

10. A **Francis Bacon** triptych, *Three Studies for a Portrait of Lucian Freud*, fetched $37 million, the top price at a sellout Sotheby's auction of 20th century art.

CLOCKWISE FROM LEFT: IMAGE SOURCE/GETTY IMAGES; CASPAR BENSON/FSTOP/CORBIS; CARL & ANN PURCELL/CORBIS; ANDREY RUDAKOV/BLOOMBERG; ADRIANO MACHADO/BLOOMBERG; SOTHEBY'S/BLOOMBERG (3)

WorldMags


facebook. found a space
for people who think in a certain way.
It's called Ireland.
IDA IRELAND
idaireland.com/innovation
IRELAND Innovation comes naturally

WorldMags

WorldMags

I'll Have My Robots Talk to Your Robots

Telepresence—communications tools so fast and vivid that people thousands of miles apart can "meet" in the same room—is finally coming of age

By Drake Bennett
Photograph by Fredrik Broden

→

Vgo Communications' $5,995 telepresence robot stands in for remote workers

WorldMags



WorldMags





Last year, according to the Global Business Travel Assn., Americans took 427 million business trips. They traveled to make sales presentations, do site visits, check in on branch offices, meet with suppliers, placate clients, lobby politicians, man job fair booths, interview applicants, and lay off employees. They traveled to attend corporate retreats, trade shows, continuing-education conferences, and bald-faced junkets. Then they traveled more to get back home.

The bill for all this was $228 billion, along with untold gallons of jet fuel, tons of carbon dioxide, hours spent in traffic, and missed family dinners. All of it because of the belief that there's no substitute for face-to-face contact. We can easily and instantly project parts of ourselves over great distances: The phone carries our voices, e-mail sends our writing, videoconferencing transmits our images. But none of these provide a sense of human presence—the feeling that a person is actually right in front of us. To size people up or win their trust or smoothly collaborate on a complex, dynamic task, you still need to be there.

In the past few years, a set of technologies has emerged with the potential to change that calculation. The term the creators of these new tools use is "telepresence." Some are custom-built meeting rooms with a bank of high-definition screens and cameras, others take the form of vaguely humanoid robots. None of them fool people into thinking their distant interlocutors are right there, any more than viewers at a 3D movie really think they're in danger during an on-screen car chase. The moviegoers still flinch, though.

"You can look somebody in the eye," says Rich Redelfs, a partner at the venture firm Foundation Capital, which uses a telepresence suite built by Cisco Systems to meet with companies—many of them in India—that the fund is thinking of investing in. "A lot of what we do in venture is, we invest in people. You want to look somebody in the eye and say, Do I trust this person enough to write them a multimillion-dollar check? We feel we can do that with telepresence."

Already, Fortune 500 companies such as Bank of America, PepsiCo, Procter & Gamble , and Royal Dutch Shell have installed Cisco's "immersive suites," which cost upwards of $300,000, for management meetings. P&G is also trying them out for consumer focus groups. The software company Autodesk has 20 telepresence suites worldwide and has cut travel by 16 percent since installing its first ones three years ago. The social game developer Zynga uses immersive units made by Polycom to coordinate far-flung designers and programmers; the CBS show *The Good Wife* conducts bicoastal writers' meetings through them. Hospitals are setting them up to allow neurologists to remotely diagnose stroke patients who show up in the emergency room. Polycom Chief Executive Officer Andrew M. Miller says a fellow CEO has installed a suite in the garage of his vacation home in Hawaii. "I can't tell you his name, of course, but he's one of many," Miller says.

Shell, Pepsi, and BofA have all installed Cisco's $300,000 telepresence suites



Thanks to their mobility, telepresence robots are being used by managers to walk factory floors. Health-care organizations are looking at employing them for home care; so are storage companies for security. Cisco and some of its partners are creating telepresence retail displays to ensure that a salesperson is always on hand to sing the praises of a particular product to a browsing consumer. Telepresence has even come to the coffee break: Four of Cisco's European offices have wall-size telepresence screens constantly on in the office canteen, so that co-workers hundreds of miles apart can "meet" there for a drink.

"You're able to virtualize people and resources," says Marthin De Beer, the Cisco executive who led the development of the company's telepresence offerings, in an interview conducted between two telepresence suites. De Beer now spends much of his time in a suite at Cisco's San Jose headquarters, clicking from one distant locale to another as if flipping through TV channels. "I'm frequently in five or six cities a day, and it would be impossible to get on that many planes," he says. "Rarely a day goes by when I'm not in at least three or four telepresence meetings."

Cisco and Polycom are currently the two biggest players in the field—a third, the Norwegian company Tandberg, was bought by Cisco last year—and the market they're battling over is growing. According to the technology consultancy Wainhouse Research, sales of immersive telepresence units are up nearly 60 percent over the past two years, and the total revenue for all high-definition teleconferencing will grow to $2.3 billion in 2015.

It remains to be seen what effect that growth will have on how much and how far we travel for work—and how vulnerable airlines, hotel chains, and rental car companies might be. Not every telepresence product has been a hit: The Umi, a $600 home high-definition telepresence unit Cisco launched last fall, was dismissed by most tech reviewers as a prohibitively expensive bauble unlikely to lure households away from free video chat services such as Skype. And no

ROBOTS: PHOTOGRAPHS BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

WorldMags

WorldMags

The Art and Science of Telepresence

The lighting is carefully balanced to highlight facial expressions while creating a sense of 3D space onscreen

The curved desk creates the illusion that the people in the room and onscreen are all sitting around one table

The chairs and wall color are standardized to unite the sites



What's onscreen can be a composite of feeds from different, diffuse suites

The microphones activate the screens, which shift between feeds as people chime in

Transmitting all this data takes 20 to 40 times the bandwidth of a basic Skype video call

matter how well the technology works, it's hardly the first invention to promise to obliterate distance: The 19th century had the telegraph, the 20th the fax machine and the Web, yet we travel more today than ever.

Still, the experience that telepresence provides is qualitatively different from other remote technologies–richer and more immediate. Trying them out, I found both the telepresence rooms, with their high-definition immersiveness, and the robots, simply by providing a remote body to take for a spin, defused many of the cues that make distance feel distant. The technology has its limits, but it will almost certainly get better even as it gets cheaper. Just as most people 15 years ago felt uncomfortable shopping or dating online, it is easy to imagine that interactions now understood to require physical interaction may soon become perfectly acceptable to do by telepresence. Even today, expensive as the technology can be, for many users it's being there in person that's beginning to feel like a luxury.

Being in a telepresence suite is a bit like being in a TV studio. This staginess is partly by design. Cisco suites, for example, are built to be nearly mirror images of each other, with six identical chairs arranged around an identical semicircular table facing a triptych of 65-inch plasma screens (larger suites have a second row of chairs around an outer table). A hood-shaped "light shroud" frames the screens like a proscenium arch, emitting a white glow to highlight the facial features of the people sitting before it.

When the screens come on, a user sees people seated around the other half of the table he's sitting at, in the same chairs, in front of a wall that's the same khaki hue as the one behind him–whether he's connecting to Chicago or Oslo or Seoul. Or all three: The rooms can simultaneously patch in participants from multiple locations.

This combination of factors gives telepresence meetings an odd sense of placelessness. A sales meeting I sat in on at the Cisco suite at Autodesk's Waltham (Mass.) office included employees from Sydney, Singapore, San Rafael, Calif., and Manchester, N.H. The only evidence of anyone's location were small printed signs in front of each participant, as if they were in Model U.N. During the telepresence meetings I attended, I would occasionally experience a fleeting claustrophobia, a sense that the entire world had collapsed into a single, infinitely iterating conference room.

This sensation is a testament to the power of the technology. Both the image and sound are sharper and more fluid than traditional teleconferencing technologies and far higher-resolution than services such as Skype or FaceTime. As advertised, I found I could look into people's eyes as they talked to me, and they could look into mine. I could gauge from their facial expressions when they were bored or discomfited, interested or surprised. Watching people's reactions as they listened to others talking, I could get a sense of the mood of the "room." Because there's no transmission lag, it's easy and natural for people to interrupt each other. Comments can be cushioned or emphasized by body language and small gradations in tone. And, inevitably, from time to time I found myself distracted by a strange bump on someone's lip, or the size of a person's wristwatch, or by trying to make out what someone sitting on the other side of the country was writing in his notebook. In short, it felt very like the many hours I've spent attending meetings in person.

Fundamentally, the technology varies little from Skype. Aside from the high production values, the real difference is bandwidth. The biggest telepresence suites have three video cameras and three screens, and when two or more rooms are connected to each other over a data network, each camera transmits separately to a corresponding

WorldMags

screen in the other room. A processor called a codec instantaneously compresses the stream of video and audio data as it's sent and decompresses it as it's received.

Even with the compression, however, immersive telepresence needs fat pipes: A Cisco immersive telepresence room operating at its highest resolution requires a network data transfer rate of about 12 megabytes per second. Polycom's newest codecs can cut that number in half, but that's still roughly 20 times the bandwidth of a non-HD Skype video call.

As rich as the stream of visual and audio data is, the illusion does occasionally break down. When people stand up from the table in a standard Cisco suite the camera can't follow them, so they look headless. (Polycom suites don't have this problem, and Cisco has addressed it in customized rooms such as the "virtual collaboration spaces" it designed for General Electric engineering teams.) When I used the suite in Cisco's New York office to interview Marthin De Beer, he and the two company spokespeople sitting with him in San Jose spent the hour looking not at me but at a spot in space two feet to my left—even as they remained in perfect sync with everything I said and did.

These are quibbles, though. The real barrier to widespread use is cost. While prices are dropping, the technology is still expensive, especially the units that most closely mimic actual proximity. Polycom's immersive rooms run from $200,000 to $600,000, along with a service plan that's around 10 percent of the price of the equipment itself. The monthly bill for the extra bandwidth can easily run into the thousands of dollars. And since the units are meant to communicate with each other, there's little point in buying just one. Until very recently, the only way most people could use a telepresence suite was to work for a company that had one.

Cisco and Polycom are both trying to change that by pushing into what they call "public telepresence": telepresence suites, available for rent, in high-end business hotels and executive suites around the world. In essence, these are immersive phone booths. The suites usually rent for $400 to $500 an hour—that's per room, so a call between two public rooms is double that. It's not cheap, though compared with plane tickets and time lost to travel for five or six employees, it can be the better deal. The primary users have been companies such as Foundation Capital without a suite of their own, or remote employees of companies that do.

Some at Cisco have an even more ambitious idea of what public telepresence might accomplish: They believe it can help change what it means to go to work. The proof of concept they point to is in the Zuidas district in Amsterdam, a thicket of expressionistic skyscrapers—some jagged, some undulating, some Lego-like, all of them new—a few miles south of the canals and 17th century houses of the city's iconic Grachtengordel neighborhood.

Nestled at the feet of the office and apartment towers is a two-story establishment called Amsterdam Bright City that's a hub of a nationwide social engineering experiment. The first floor is an airy café; the second has conference rooms, meeting nooks, an open area with long desks and colorful high-design office furniture, and a Cisco telepresence suite.

Amsterdam Bright City is one of over 100 "smart work centers" that have been set up around the Netherlands since 2008, under the aegis of a coalition that includes Cisco, ABN Amro, and the City of Amsterdam. It's a network of venues, each with the amenities and resources of an office—from copiers and fax machines to coffee bars and child care—but located right where people live.

The hope is that, rather than commute en masse to downtowns and office parks, a sizable segment of

Research suggests that people are quick to humanize robots, even when they don't look particularly human



PHOTOGRAPH BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK


Opportunity doesn't always
arrive gift wrapped.
Some thoughts on unlocking potential in today's environment: 1. Innovation is essential, especially if it's disciplined and focused on business outcomes; 2. Out-thinking the competition is useless unless you can out-execute them as well; and 3. This is no time for trial and error; winners get it right the first time. Talk to us to see how we can help you turn potential into tangible performance.
• Consulting • Technology • Outsourcing
accenture
High performance. Delivered.
© 2011 Accenture. All rights reserved.
WorldMags

WorldMags

the workforce will, at least part of the time, go to work at their neighborhood smart work center, just as they shop at their local grocery store or drink at the corner bar. People from different companies would work alongside each other, connecting to their colleagues remotely—driving less, spending less time in traffic, their cars emitting less carbon dioxide. (Set almost entirely below sea level, the Netherlands is particularly attuned to the ramifications of climate change.) The eminently Dutch goal of the smart work center coalition is to build enough of them that everyone in the country lives within 15 minutes of one—by bicycle.

"We claim that we've been living in the Information Age for 20 years, but you could easily argue that that's not the case," says Bas Boorsma, a director of Cisco's consulting arm, the Internet Business Solutions Group. Boorsma is one of the driving forces behind the smart work centers. We were sitting in the center's telepresence suite after a meeting he'd organized. "We have merely utilized information technology to optimize the Industrial Age, and we're acting as if we're still commuting to our factories," he says.

Twelve of the centers are scheduled to have telepresence suites by the end of 2011; Bright City is the first. The suites seem to be, in part, high-tech enticements to get workers, or their employers, to pay the $500 monthly membership fee. But they also serve a more central purpose: The richer and more realistic the tools available to connect to other offices, the more willing people will be to work remotely. "It allows people to do their work independent of where they are, to participate even in sensitive negotiations and performance reviews by network means rather than having a real physical meeting," says Boorsma.

Even for a country as doggedly progressive as the Netherlands, the sort of wholesale reorganization of work that Boorsma is talking about is hugely ambitious, and unprecedented. The two smart work centers I visited, in the Zuidas and the Grachtengordel, had people spread around the workstations and meeting rooms, but also plenty of empty seats. At the same time, there is some evidence that people are starting to use telepresence as they would in a smart work center: to replace much of the daily interaction of a workplace.

Some have begun to use telepresence to replace not just flights but car trips across town



Alexandre Pelletier handles European telepresence sales for Tata Communications—Tata provides network connections and maintenance for Cisco's suites in much of the world. Some of his clients, he's noticed, are using the suites to replace not just transcontinental flights but car trips across town. Separate engineering teams at the carmaker Peugeot, for example, will routinely convene by telepresence, even though the offices where they're working are all right around Paris.

Only so much work can take place within the walls of a conference room, real or virtual. Just ask a road warrior. "Most of my clients, when I go in the building, I'm saying hi to 10, 12, 15 people before I even get to the meeting I'm going to," says Mark Fetner. an account executive at Blackbaud, a Charleston (S.C.) company that sells specialized software to nonprofits. Fetner spends two weeks a month on the road, enough to earn Platinum Medallion status on Delta Air Lines. "Every organization has a social network that you have to understand and build a relationship around to get a program off the ground," he says. "And every time you go back you build more rapport. It's like the old Peter Drucker 'management by walking around'—you learn a lot that way."

A whole swath of the global economy is based on people like Fetner. While numbers vary from airline to airline and hotel chain to hotel chain, few among them would survive in anything like their current form without business travel. Half of American Airlines fliers are business travelers, and although the airline won't specify exactly how much, they provide significantly more than half its revenue. Avis Rent A Car System derives 60 percent of its time and mileage revenue from business travelers. High-end restaurants rely on business travelers on expense accounts. So do sports franchises—all those revenue-generating corporate boxes for entertaining clients. And all the bachelor parties and benders in the world couldn't save Las Vegas if no one went to its conventions.

"Certainly the profitability of the travel industry at large comes from business travel," says Mike McCormick, executive director of the Global Business Travel Assn.

McCormick, for one, doesn't see telepresence as a threat to those industries. Business travel dropped sharply during the recession—from 269 million trips in 2007 to 223 million in 2009—and hasn't yet recovered. While some environmentally conscious firms such as Autodesk have used telepresence to make permanent cuts in travel as part of a carbon emissions reduction strategy, many more were simply reacting to the economic climate. Over the past year, travel numbers have started climbing back.

"Telepresence isn't a replacement factor," McCormick says. "To put it simply from a business perspective: The first time you lose a customer because you were there in telepresence and your competitor was there in person is the last time you use telepresence."

For those such as McCormick who believe that business still requires shared confidences over expense account dinners and brief conversations through open office doors, there is at least one attempt to capture technologically that dynamic over distance: the telepresence robot.

Telepresence robotics is a far smaller corner of the tech world than immersive telepresence. Rather than being the battleground of Silicon Valley giants, it's the province of small startups. And analysts are sharply divided over how big it can get. Andrew W. Davis, the co-founder of Wainhouse Research, doesn't see much potential. "When you look at the value added by mobility [vs.]

PHOTOGRAPHS BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

WorldMags



STATE STREET.

LISTED NYSE ARCA

Before investing, carefully consider the funds' investment objectives, risks, charges and expenses. To obtain a prospectus or summary prospectus, which contains this and other information, call 1.866.787.2257 or visit www.spdrs.com. Read it carefully.

ETFs trade like stocks, fluctuate in market value and may trade at prices above or below the ETFs net asset value. Brokerage commissions and ETF expenses will reduce returns.

The SPDR S&P MidCap 400 ETF Trust is an exchange traded fund designed to generally correspond to the price and yield performance of the S&P MidCap 400 Index.™

Foreign investments involve greater risks than US investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.

Bond funds contain interest rate risk (as interest rates rise bond funds usually fall); the risk of issuer default; and inflation risk.

Because of their narrow focus, sector funds tend to be more volatile than funds that diversify across many sectors and countries.

Small company stocks are generally riskier than large company stocks due to greater volatility and less liquidity.

"SPDR®" and MidCap SPDR® are registered trademarks of Standard & Poor's Financial Services, LLC ("S&P") and have been licensed for use by State Street Corporation. No financial product offered by State Street or its affiliates is sponsored, endorsed, sold or promoted by S&P.

ALPS Distributors, Inc., a registered broker-dealer, is distributor for the MidCap SPDR Trust, a unit investment trust.

IBG-1872

WorldMags

the cost of mobility, I believe it's going to remain a small niche market," he says. The tech consultancy ABI Research, however, published a study last fall that predicted that the worldwide market for telepresence robotics would grow from $556.1 million in 2010 to $13.1 billion in 2016. Larry Fisher, one of the study's co-authors, argues that the uses for the robots will shift as the market grows, from security and surveillance—which he includes under the umbrella of telepresence—into remote meetings and virtual collaboration.

There are a few models of robot currently available, and they are in high demand—one company, Vgo Communications, quickly sold out its first production run of 100. Another, Anybots, currently has an order backlog of a month and a half. One of Anybots's clients is an Arlington (Va.) energy efficiency software start-up called Opower, which is still awaiting the delivery of its $15,000 robot. "I call it Skype on a Segway," says Daniel Yates, Opower's CEO. "I'm prepared for it to be a gimmick and not pan out. I'm hopeful that it won't be."

Vgo's robot is smaller than the Anybot, and, at just under $6,000, significantly cheaper. (There is a $100 per month service fee.) Four feet tall and shiny white, it looks like an apprehensive, undernourished ghost. Two shapely plastic stems rise out of a wheeled base and meet in a bight of tubing inlaid with microphones and rounded like a head. The robot's face is a video screen and its single eye a video camera; its base has headlights and sensors to alert it to obstacles. The whole apparatus is pitched slightly backward, as if recoiling in surprise.

Reporting this story, I was incarnated as a Vgo on multiple occasions, sitting in New York at my laptop while conversing and moving around Vgo's offices in Nashua, N.H. The employees there seem accustomed to stepping around poorly controlled Vgos, stopping only to offer good-natured advice about not oversteering. As they bent down to speak to me, they saw my face projected from my Webcam onto the robot's video screen, my expression one of concentration mixed with embarrassment.

And, at times, frustration. Because of a problem with the Internet connection between my computer and the robot, during my initial attempt I could hear only faintly what was being said to me,



↑ **Telepresence technologies in office cafeterias allow workers in different countries to share a meal or a coffee**

often with a delay, and my link cut out completely after a few minutes. Then, after I had wheeled painstakingly up to the desk of company co-founder Tom Ryden and raised my camera so I was looking at his face rather than his solar plexus, my microphone went dead. I had to resort to a feature that allows users to type things out for the Vgo to recite in its monotonal robot voice. It made for a stilted conversation—Ryden was speaking, I was essentially texting—and through my cyclopean robot eye I watched him gamely simulate a facial expression of equanimity.

My second try, the next day, was a very different experience. A blizzard had settled over New England that morning, and Ned Semonite, the marketing executive who was supposed to coordinate my visit, couldn't make it to the office. He told me to go ahead and log into my loaner Vgo, that my interviewees there were expecting me to come find them.

I set out to do so, at first moving haltingly and then with a bit more confidence—the Vgo's top speed is about that of a leisurely walker. I wandered the office kitchen, then browsed shelves of robot parts. I used the video camera to take a picture of myself in a wall mirror. But I didn't see any people. What I encountered were other Vgos. One cut across my narrow field of vision with a Dopplerized whine, then another, going the other way. I saw a third pass a doorway a little ways off. I found a fourth standing by the entrance to the kitchen and eased shyly up to it only to realize it wasn't on. The whole thing was wonderfully surreal: I could have been in any one of a thousand office parks, except that the workers were four-foot-tall white lollipops with human faces, whirring purposely to and fro. So was I.

It was a shock when an actual human being loomed up in my monitor. It was Ryden, who had come to continue our aborted conversation of the day before. Because of the blizzard, he was one of

PHOTOGRAPH BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

WorldMags

WorldMags

the few employees to show up that day. Some of his colleagues were arriving later. But some, he explained, were just staying at home—at least in their corporeal form. They were at the office as their Vgos, roaming from cube to cube.

"On snow days we'll have well over half the guys on Vgos," Ryden later told me. "They'll stop and chat with each other, robot to robot. You'll be walking down the hall and see two guys just chatting away, and they're both in some other location."

There is a body of research on human-machine interaction, on how people relate to the increasingly smart devices that surround them. One finding is that it doesn't take much to get people to bond with a robot, even one that doesn't look or sound anything like a person. Pamela J. Hinds, a Stanford University professor of organizational science, has looked at how doctors and nurses interact with HelpMate robots that transport drugs and other supplies around hospitals, and how a team of researchers working in the U.S. treated the remote rover they used to collect samples in the Atacama Desert in Chile. "I think one of the things that surprised us the most was the extent to which they were anthropomorphized, even when they were these big, boxy file-cabinet-looking things," Hinds says. All a robot had to do was move around in a purposeful way, and people thought of it, in some ways, as a co-worker. People invariably give their robots names and talk about the robots' moods and tendencies. Hinds recalls seeing one HelpMate to which hospital workers had attached a pair of googly eyes.

Hinds also studies "distributed work": the dynamics of work teams divided by geography. Perhaps thanks to her particular intersection of interests, she sees in telepresence robots an intriguing, potentially powerful solution to some of the difficulties those teams face. "With telepresence robots, there's a number of things that I think are incredibly cool," she says.

Mobile telepresence isn't just a gimmick, she argues—it qualitatively changes what a remote user can do. It allows people to recreate the sort of serendipitous social encounters so common in flesh-and-blood office life. "I don't depend upon other people coming to see me, I can run into people and have spontaneous conversations with them, and that is really important," she says. The lack of those informal conversations—the sort of communication that doesn't find its way into e-mails or phone conversations or meetings—is a large part of why working remotely for a sustained period can be so difficult.

If Hinds's robot research is to be believed, mobility isn't just useful, it's also humanizing. The mere fact that telepresence robots move, however stiffly, is what makes them such effective stand-ins for people.

Some of Vgo's customers tell a similar story. One of them is Reimers Electra Steam, a small company in Clear Brook, Va., that manufactures boilers. Last July the company's electrical engineer, Erwin Deininger, moved to the Dominican Republic when his wife's job transferred her there.

At first, Deininger would attend meetings back in Virginia through Skype. If he needed to see something on the shop floor, which he often did, a colleague would carry around the laptop Deininger had connected to, pointing it where he asked. Someone had to be essentially tasked as Deininger's remote body, and if no one was available he was stuck. "It tied up manpower, and it didn't give him the flexibility he needed," says Roger L. Burkhart, Reimers's president.

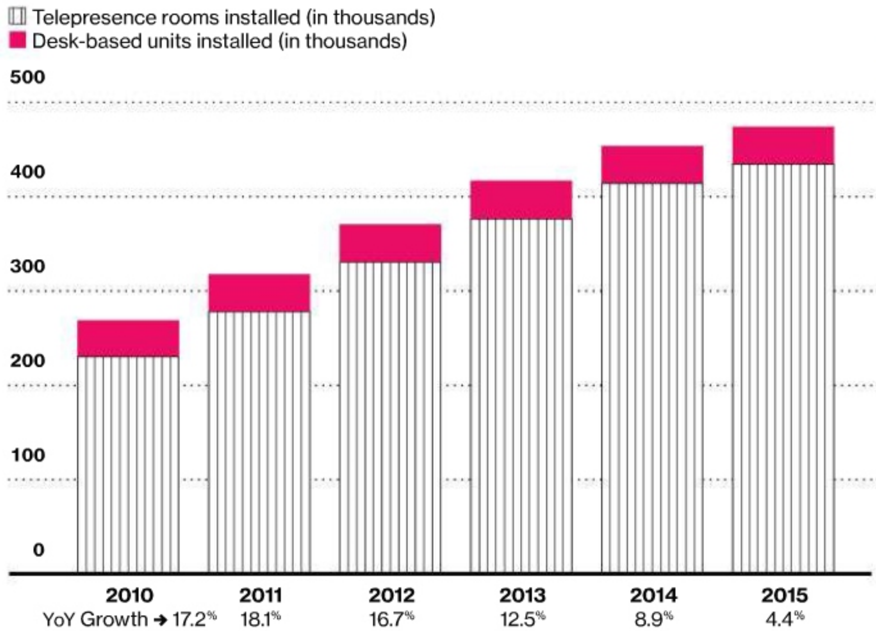
Burkhart did some research and found out about Vgo. The robot arrived in December, and now Deininger wheels easily from desk to desk and around the shop floor, answering questions and inspecting designs, often using the robot's photo feature to examine wiring in detail. Burkhart and other senior managers also occasionally use the Vgo to check into the office from home.

If Burkhart has been pleasantly surprised at how useful the robot has proven, he's even more struck at how he acts around it. To a remarkable degree, he says, he now conflates the robot with its user. He finds it hard to not think of the robot as, in a very real sense, Deininger himself. "Little Erwin comes rolling into the office at 10 a.m. every morning," Burkhart says. "When you're talking to Skype, you're always talking to a computer. When the robot is there, because it turns around and faces you, it takes on the personality of the individual. You're hearing his voice, you're seeing his face through the video, you've got movement involved.

"After a while," he says, "it's not a robot anymore." B

Growth in Telepresence Sales

Sales of telepresence rooms are projected to grow in the next few years, but growth will slow as cheaper products begin to provide many of the same benefits.



DATA: WAINHOUSE RESEARCH



WorldMags

TPG's co-founder Jim Coulter: "It's time for us to enter the narrative"

The Operators

Can private equity beat the market again? Mega-shop TPG makes a $48 billion bet that the answer is → YES

By Jason Kelly

Photograph by Gabriela Hasbun

It's a late August morning in Jim Coulter's office on the 33rd floor of one of San Francisco's tallest buildings, and the view has cleared. With the fog burned off the Bay, the Golden Gate Bridge is glittering in the sunshine. It's a glorious San Francisco moment, but Coulter doesn't seem to notice. Instead he's at a whiteboard, diagramming the private equity business in green marker.

"It's a three-box model," Coulter says, drawing boxes and filling them in with abbreviations—"SP" for "stockpickers," "DG" for "deal guys," and "PM" for "portfolio managers."

Coulter, 51, along with David Bonderman, 68, is co-founder of the 19-year-old private equity firm TPG Capital, which has engineered many of the largest and most visible deals the industry has seen, including the 1997 purchase of J. Crew for $475 million and the 2006 initial public offering, which valued the company at $1.1 billion; the $43.2 billion acquisition of Texas utility TXU, renamed Energy Future Holdings; and the $27 billion takeover of casino company Harrah's, now known as Caesars Entertainment. TPG, with 278 employees in 14 offices, controls $48 billion of investments, putting it at the top of the private equity world, along with Blackstone, Carlyle, and KKR. Such success has put Coulter at No. 221 on *Forbes'* list of the wealthiest Americans, with an estimated net worth of $1.8 billion. (He is tied with Bonderman, also at $1.8 billion.)

Each player in the buyout industry uses its own blend of Coulter's three boxes. TPG, Coulter says, emphasizes portfolio management and deals. Portfolio management isn't about stocks. Rather, it's a focus on improving the performance of acquired companies, often in the tiniest ways. Coulter argues that it's TPG's operations team—60 fixers who go into companies and search for efficiencies—that sets the firm apart, not the stockpickers or deal guys, who put the purchases together. "There is some secret sauce to what we do," he says.

"Private equity," strictly speaking, describes a business that deploys capital outside of the public markets, but the "private" is often emphasized in its secondary meaning as well. It's traditionally among the most secretive of businesses, partly because a deal is like a poker hand, best deployed by surprise, and partly because the fees, and some of the industry methods, such as paying out enormous dividends from overleveraged acquisitions, work better when no one is watching.

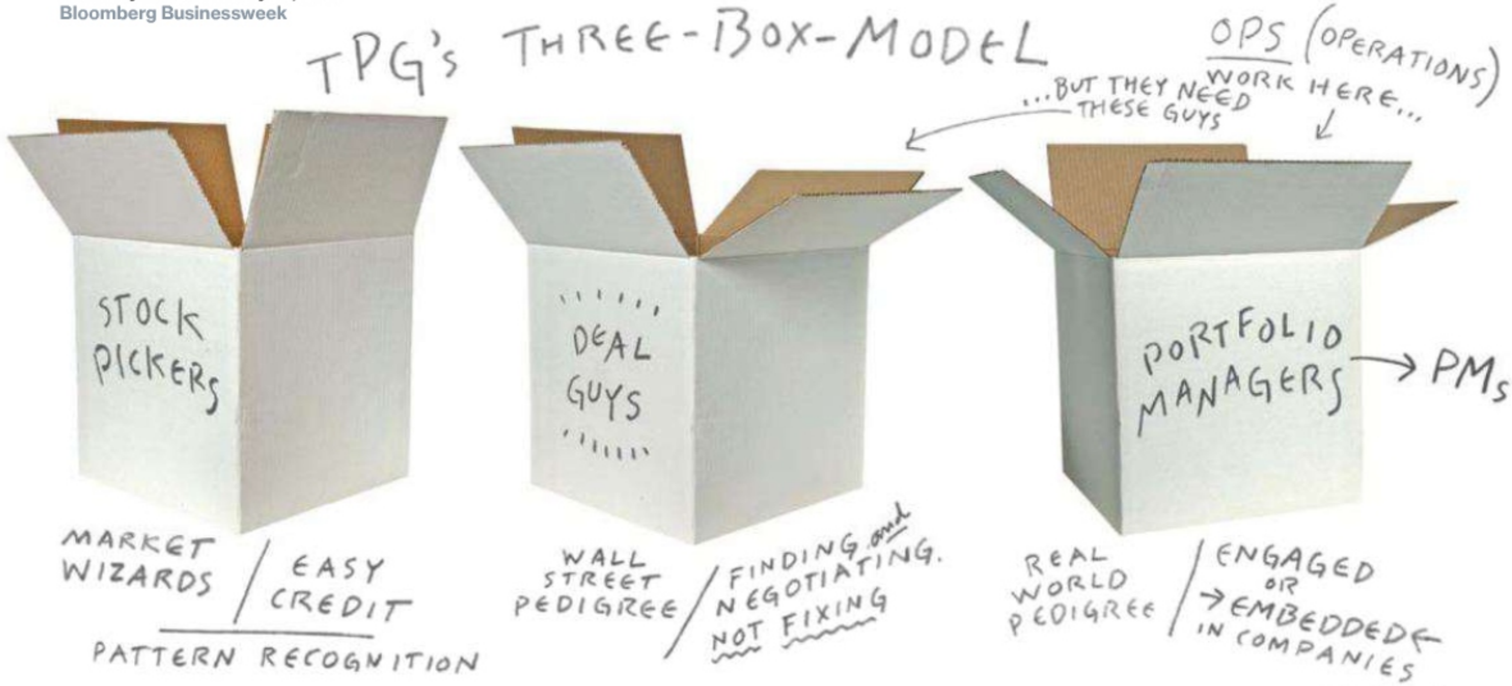
That has changed, to some extent, as private equity firms have gone public. Both Blackstone and KKR are now publicly traded, and Carlyle is said to be mulling an offering in 2011. TPG has held out, and Coulter says there are no plans to take the firm public.

It's unusual for TPG to invite a reporter into the firm, but these are



WorldMags

WorldMags



unusual times for TPG, and for private equity. Returns, in aggregate, are beginning to look a lot like those of the market, which threatens the rationale for the industry and its eye-popping fees—usually 20 percent of any profit it creates for investors, along with a 2 percent management fee, win or lose.

In general, an investor in private equity commits money to a fund for 10 years. Thus, most judge a fund's performance after it's had five or so years to make investments, grouping them by "vintages," the year a fund started investing. According to PitchBook, a private equity deal database, the average return for funds raised in 2001 was 22 percent, while funds from 2005 were averaging 4 percent. TPG's funds, in that time, returned similar results. And it's still lugging around boom-era baggage, including Energy Future and the memory of losing $1.3 billion in a minority investment in Washington Mutual.

The profile of its deals and the wider notoriety of the industry in the public and political spheres mean TPG can't operate in the shadows anymore, unless it wants its critics to be the only ones talking. "We're more in the public eye," says Coulter, who argues that some of the anger at private equity, from anti-Wall Street politicians, labor leaders, and disappointed investors, comes from a misunderstanding of what the firms—and his in particular—actually do. "It's time for us to enter the narrative," he says.

Still, some habits aren't easily broken. As Coulter fills his whiteboard with explanations, he's also playing the poker game. A few days later he'll fly to New York City for a dinner meeting with J. Crew Chief Executive Officer Mickey Drexler, setting in motion an offer to purchase J. Crew—again. This time, for $3 billion.

Like the rest of the industry, TPG is still coping with a buyout boom that was powered by cheap credit—and destroyed by its sudden disappearance. The boom crested in 2006 and 2007, when 9 of the 10 biggest deals in history were announced. Among them was the acquisition of TXU and the purchase of Harrah's, both TPG projects.

Private equity firms are under scrutiny not just from the public but from their investors, who have poured record amounts into buyout funds. Those institutional players, still tender from the financial crisis, are demanding more information from firms they already invest in as well as those looking for fresh commitments. They're also questioning how much they'll pay for the privilege of investing, according to observers such as Colin Blaydon, director of the Center for Private Equity and Entrepreneurship at Dartmouth College's Tuck School of Business. "Every investment that's being done now, the fee issues are right upfront," he says. "This is a big conversation that's going on everywhere."

Private equity's performance vs. the public markets has been compelling, especially from 1998 to 2005, says Steven Kaplan, a professor at the University of Chicago Booth School of Business, who has done extensive research on private equity returns. "This was a period when firms like TPG had begun to invest in operational capabilities," Kaplan says. "They did better than the public markets over that time, and that's why so much money came in." The problem, he says, is that as the industry grows and competition for each deal increases, "the excess returns get competed away."

Right now firms such as TPG are ready to prove their merit. Private equity firms collectively emerged from the crisis with more than half a trillion dollars in commitments they needed to spend, according to PitchBook. TPG has $17 billion. The open question is whether or not they can spend that money wisely—or at least more wisely than the market overall—when adjusted for their fees.

The deals getting done now are different from those in the boom, and Coulter believes that benefits TPG. "We've seen something of a fundamental change," says Dartmouth's Blaydon. "There are three ways to make money in a leveraged buyout—the capital structure, buying low and selling high, and actually improving the cash flows of the company. The last is the only one that investors think can actually deliver the returns in the future, given everything we've gone through."

Investors "are much more interested today in how you're going to deliver that value you're promising," Coulter says. "They say, 'Give me examples.'"

As for the investors, "We measure success by [earnings before interest, taxes, depreciation, and amortization] growth as opposed to balance-sheet restructuring," says Alan Van Noord, chief investment officer of Pennsylvania's Public School Employees Retirement System. "Managers understand that they have to be more operational in nature and that financial engineering only goes so far."

ILLUSTRATIONS BY C. HOFFMAN

WorldMags

COULTER ONCE FOUND A MEAL ON CONTINENTAL SO BAD HE FEDEXED IT BACK TO HEADQUARTERS

TPG is hardly the only firm responding to criticism by showcasing its operations skills. Clayton, Dubilier & Rice, a competitor, has former General Electric Chief Executive Jack Welch, who works with the firm as a special partner. Part of his job is to keep CEOs motivated. The firm also has former Procter & Gamble CEO A.G. Lafley and Gap chief Paul Pressler, a retail expert. KKR has an internal operations group called Capstone that has doubled its head count since 2007, to 60.

Greg Brenneman, now chairman of private equity firm CCMP Capital Advisors, ran TPG companies that included Continental and Burger King. Brenneman, who stays in touch with TPG's Bonderman—at minimum, they have a standing yearly breakfast in Colorado—says the financial engineering days are over, giving an advantage to fixers such as his firm and TPG. "It really is how you're going to make money in the next five years in private equity," Brenneman says. "The operators are back on top again."

In early September, just weeks after the still-secret J. Crew meeting with Drexler, Coulter is in New York and swings by a small conference room with a view of Central Park where Richard "Dick" Boyce has set up for the week. A former Pepsi vice-president for strategic planning, Boyce has run TPG's operations group out of San Francisco for 14 years.

"I'm definitely a process maven," says Boyce, patting a stack of spreadsheets as though it were a favorite pet. Charts, he says, are his mother tongue. At one point, grasping for a way to explain his duties, he concedes, "I tend to think in slides." He'll often grab a piece of paper and sketch out a timeline or interlocking circles to illustrate a point.

Coulter, too, with an engineering degree from Dartmouth, is a self-described nuts-and-bolts guy. Like Boyce, he thinks and speaks in bullet points. You get the feeling that he likes taking things apart just to put them back together. If you had to put the founders in their own boxes, Coulter might be the portfolio manager, while Bonderman, who will hop on his private plane at a moment's notice to have lunch with a CEO, is more of a deal guy. (Bonderman, a constant world traveler, flies his used Falcon 900 in excess of half a million miles in most years.)

These days, 60 people work for Boyce in operations, up from just one when TPG bought J. Crew back in 1997. "Before, it was some guys with some good ideas," says Boyce. "It's a business now." His employees include specialists such as Deb Conklin, a senior adviser in San Francisco for the operations group who spends months embedded in TPG-acquired companies, figuring out everything from the optimal place to store parts on an assembly line to how a casino buffet should be arranged to maximize profit. Coulter—like the rest of TPG—calls Boyce's department the "ops" group and says that from the beginning he'd hoped it would be a crucial part of the business.

Coulter and Bonderman met during the late 1980s, working in the office of Robert Bass in Fort Worth, alongside such managers as future Colony Capital Chairman Thomas J. Barrack Jr., Lone Star Fund's John Grayken, and future TPG partner Kelvin Davis. Lawyer Bonderman linked up with former investment banker Coulter, then in his late twenties.

The two spun out of Bass, joining GE Capital's Bill Price, to pursue a purchase of Continental Airlines in 1993, pooling their own money along with cash from other private investors in a deal that would launch what was then called Texas Pacific Group, in a nod to their having had offices in Fort Worth and San Francisco. The Continental deal was a coup: TPG made more than 10 times its initial $60 million investment in about five years, mostly through operational improvements in customer service. Food and baggage handling were a focus. Coulter, flying coach with Bonderman one day, found the meal so bad that he FedExed it to headquarters.

Bonderman says the Continental deal gave birth to the idea of an operations-centered investment firm. "That put us on the map in the first place," he says. "In the popular psyche, there's a lot of respect for Henry Ford being an industrialist but not for those considered financial engineers. There's an undercurrent of that, and it's important for us to make it clear that we actually add value."

Emboldened by Continental, Coulter and Bonderman began to think about how to build a firm. "It was very important that we build for the long haul," says Coulter. He and Bonderman were convinced that the messiness of deals such as Continental was part of the opportunity and decided they wanted to institutionalize operations. Coulter, then 32, spun his Rolodex and got in touch with Boyce, whom he'd first met as a Stanford Business School summer associate at Bain & Co., where Boyce worked.

Through deals such as Continental's, TPG posted some of the best numbers in the industry during the 1990s and into the last decade. Its 1994 fund had an average annual return of 36.3 percent, according to data provided by the Oregon Investment Council, which manages that state's employees' pensions.

TPG's 2000 fund had an average annual return of 24.6 percent and returned 2.5 times investors' money, according to the California Public Employees' Retirement System. The average fund of that vintage in the CalPERS portfolio had a return of 7.9 percent and 1.4 times invested capital. More recent comparisons for TPG haven't been as strong. The firm's fourth fund, vintage 2003, is valued at 13.2 percent, about half the CalPERS average of 23.4 percent that year. TPG's ability to get back to those historic highs will come down to its ability to fix what it already owns and to improve the fortunes of its next purchases.

To better the odds of an operational victory, Boyce and his team work in tandem with the deal partners on due diligence, rather than just parachuting in once the paperwork is signed. "On the front end, we help the deal team lean forward and see things that are heavily discounted by another buyer," he says.

Boyce keeps a chart of the skills of each partner in ops. It lists that partner's strengths, reminding Boyce who's a procurement guru, who knows how to tweak a supply chain, and who's an expert on "lean" manufacturing, the art of producing the most with the least effort. Both Coulter and Boyce stress that operations can only be successful if the ops guys are equal to the deal guys in stature—and pay. So at TPG, ops partners are full partners in all profits rather than deal-by-deal hires.

Every company TPG acquires is color-coded red, green, or yellow. Most start out red and stay that way for a minimum of a year. If all goes well and J. Crew's shareholders approve the takeover, Boyce will have the retailer in one of those categories by summer.

Coulter already serves on J. Crew's board, and while it's far from a company in need of a turnaround—net income more than doubled in 2010—J. Crew may benefit from TPG's approach, especially in expanding into markets such as China. Coulter and Boyce can't speak about J. Crew in detail yet, as the deal has not closed, but a person familiar with its plans suggests that TPG is taking J. Crew private—just five years after taking it public—to spend heavily on international expansion and to build new brands such as Madewell. A publicly traded



PHOTOGRAPH ILLUSTRATION BY CREDITTK

WorldMags

WorldMags

company can be averse to sudden large expansions, which can destroy reported earnings. Privately owned companies face less quarterly pressure.

"We used to come in and do cost work. And if you did that, you had a pretty good exit," says Boyce, an "exit" being the industry term for selling out of a position. "One evolution is that we know we have to be more holistic. If you believe in a challenging economy, you realize you can't cost-reduce your way to glory."

Boyce embodies a type of partner Coulter likes to find and hire—someone who has worked as a consultant and inside a company, actually doing the work the consultants prescribe. That makes an ops guy coming in from a new owner more of a kindred spirit and less of a Wall Street shark. Coulter has a bias toward what he calls "academy companies" such as GE and Pepsi, where Boyce and others learned how corporations work.

As for Boyce, he staffs his ops team with people such as Deb Conklin, an industrial engineer who ran a division at Stanley Works. At Houston's Valerus Compression Services, which makes equipment for the natural gas industry, Conklin tromps around the company's facility near Bay City, Tex., in steel-toed work boots and a hard hat, one of the many get-ups she has worn as part of the field operations unit. She walks through the plant shaking hands like a politician, noting how one operational tweak was inspired by the way weights are stacked in a gym.

During four years at TPG, Conklin, 40, has also been a casino hostess and housekeeper at Caesars while serving as the gaming company's vice-president for continuous improvement. She currently spends most weeks in San Diego at LPL Financial, a brokerage firm TPG also owns. "People like me are bored doing the same thing every day," she says.

While Apollo and TPG were renovating Caesars's capital structure—cutting the debt by about $5 billion through a series of exchanges and balance-sheet restructurings—Conklin was embedded in the company. She spent more than a year at Caesars, visiting almost every property, looking for ways to apply her specialty, lean manufacturing methods, to a service business. To that end, Conklin tracked the movements of a short-order cook, creating a "spaghetti chart" illustrating every movement during an eight-hour shift; in that time the cook traveled more than three miles. TPG analyzed the data and then interviewed the cook, tools in hand. To make his route shorter, they moved the hinge of a refrigerator so he wouldn't have to walk around to open it and moved the spice rack so he wouldn't have to take a step to get to it.

In the end, TPG had the housekeepers change their routine in seemingly minor but ultimately productive ways, devising a method for making a bed so each corner need be lifted only once for all four sheets and blankets, not individually for each piece of bedding.

The numbers at Caesars have stabilized. It's generating profits of about half a billion dollars a quarter, but this was a company whose debt load, combined with a vicious drop-off in business that affected every casino on the Strip, took it to the edge of default in 2009. TPG, having pared the debt, filed to sell shares to the public to fund expansion in October. The following month the firm pulled the IPO, citing market conditions. TPG has yet to make any announcements about a second try.

At J. Crew, TPG's first ride was operations-heavy. TPG installed Mickey Drexler as CEO and rapidly built the then-catalog company into a retail chain that also had a significant presence on the Web. The first J. Crew deal worked magnificently by top- and bottom-line measures: TPG and its investors made more than six times their money after J. Crew went public.

TPG's acquisition of TXU marked the peak of the private equity boom. Announced in February 2007, the $43.2 billion acquisition, made alongside KKR, of the biggest power producer in Texas broke a still-fresh record set by Blackstone's $34.1 billion purchase of Equity Office Properties a month before. For investors, TXU may stand as a test of private equity's, and TPG's, ability to make returns on massive deals. It was also a chance for Bonderman to push his green agenda—he is a board member of the World Wildlife Fund—and TXU announced soon after that it would set about cutting its number of coal plants from 11 to three.

TPG is still coping with other vestiges of the buyout boom, including positions in Univision and Freescale Semiconductor. The former chip unit of Motorola, Freescale has undergone an overhaul that brought it from the brink of failure to an expected IPO this year.

While the operations department has played a crucial role in reversing the fortunes of Caesars, TXU falls into the stock-pickers box, a bet on energy prices and the economy, which may explain some of the results. The outlook for the company, while better than it was two years ago, when talk of default loomed, is middling at best. KKR and TPG each value the company at about 20¢ on the dollar. The major concern is TXU's debt, totaling more than $40 billion, according to Bloomberg data. A decline in natural gas prices last year sent the bonds tumbling, deepening concerns that it would be able to service the debt. Moody's Investors Service says the utility faces a "very weak financial profile, untenable capital structure, questionable long-term business plan, and material operating headwinds."

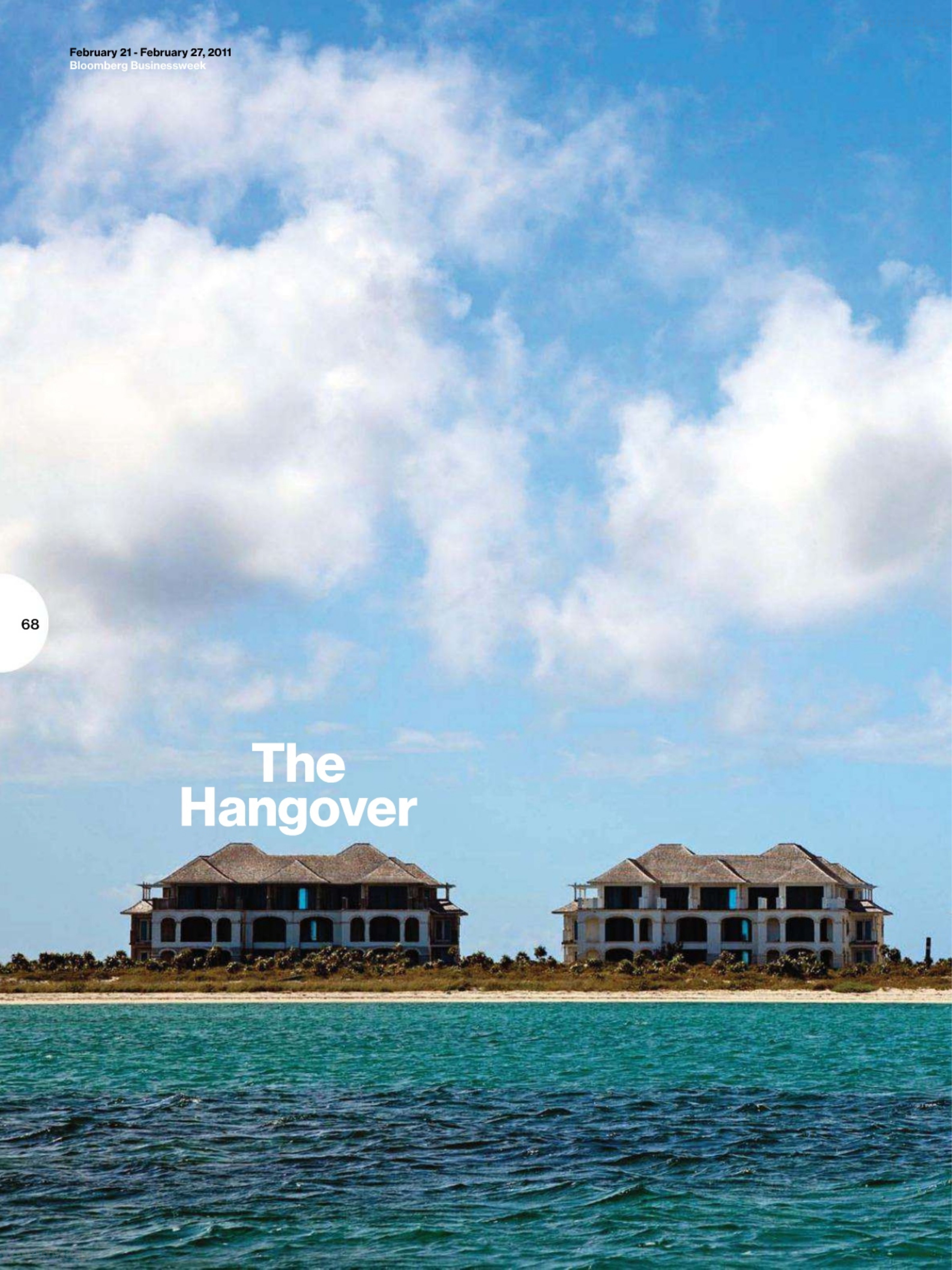
"For the 2006- and 2007-vintage deals, you're playing defense with ops," Coulter says. "The surprise to many people is that those companies didn't crash. These companies have done much better than the prognosticators expected." TPG believes TXU, now Energy Future, will make it and make money. It'll just take longer than the firm originally expected.

Months later, in mid-January, the snow is piling up in midtown Manhattan as TPG partners gather from around the world for their annual meeting. This go-round is held at the Mandarin Oriental Hotel at a corner of Central Park. The 54 partners, whose interaction throughout the rest of the year is mostly limited to videoconferences, phone calls, and e-mails, convene on the 36th floor of the hotel for two days of sessions and updates. The J. Crew deal remains on track, even as the company seeks to settle lawsuits brought by shareholders over the deal. A special meeting of stockholders is scheduled for March to vote on the transaction.

The meeting happens in the conference rooms at the top of a sweeping staircase that leads up from the lobby. A guard stands by a velvet rope, and *Bloomberg Businessweek* is allowed to pass.

Coulter emerges from a room and notes that the tone of the partners' meeting is the most optimistic in years and a marked change from even a year earlier. Then, the partners decided to be aggressive even in the face of broader fears about a double-dip recession. Now, Coulter says he's exhorting them to get stuff done. "A year ago, the financial market was still all about fighting fires," he says. "The main theme this year is that this is our type of economy. We're telling our guys to ignore the industry noise, focus on creating value, and 'Just go do it.'" With that, Coulter slips back into the general meeting, behind closed doors.

WorldMags



The Hangover



Construction on a Ritz-Carlton resort on West Caicos was halted in 2008; Lehman Brothers was the major backer

Turks and Caicos was poised to become the Monte Carlo of the Caribbean. So how did it end up a tropical hell?

By Irin Carmon
Photograph by Kevin Cooley

WorldMags

Marauders, drifters, tourists, and fortune-seekers come and go, yet the unspoiled Caribbean of the imagination endures. Up here, 1,500 feet above the Turks and Caicos Islands, it's easy to believe that there's still such a thing as virgin territory, that it's possible to start over in a perpetually golden-lit and languorous world. "We call it the land of prosperity and blind optimism," chirps Lucy Mott Lee from the backseat of the single-engine Cessna piloted by her husband, Jeff.

Spread out below are the 40-odd islands, most of them uninhabited, that make up Turks and Caicos. The blue water is so clear you can count every reef, so still you can see the odd cloud reflected in it. Lucy and Jeff have agreed to offer a view from the sky of what wary developers wrought on the ground: shuttered private-island resorts and abandoned luxury hotels marring the landscape, suspended in time by financing woes, criminal investigations, or both. This British territory, largely undeveloped in the 20th century, became a playground for celebrities and the ultrarich as its reputation grew along with the easy money and loose credit of the boom years. In the last 10 years, dozens of new developments were started, almost all of them aimed at the most extravagant end of the luxury market. When the credit spigot was shut off, it didn't take long for things to screech to a halt.

The economic collapse was exacerbated by a charismatic and allegedly corrupt leader, Premier Michael Misick, whose actions helped drive Turks and Caicos into financial and political ruin, according to evidence presented by a Commission of Inquiry that was appointed by the local British governor at the recommendation of the British Parliament's Foreign Affairs Committee. Once, condos couldn't be built fast enough to meet demand; now the money has vanished, and locals wonder whether there are enough prison cells for the former government officials being investigated by the British special prosecutor.

Around the world, the popping of the credit bubble has resulted in relatively few arrests. In countries such as Greece, Ireland, and the U.S., taxpayers are footing most of the bill for what happened in that murky zone between greed and criminality. The British have determined that here it will be different: There will be a full accounting, there will be consequences, and then this island nation will start over. In 2009, as the global economic chill hit Turks and Caicos, which had enjoyed a peak annual gross domestic product of $800 million the year before—65 percent from construction, finance, and tourism—the British announced that they'd found evidence of deep-seated corruption throughout the state. After public hearings two years ago, they dissolved the ministerial government, suspended parts of the constitution, and postponed elections. Civil and criminal investigations are under way.

Turks and Caicos still has exquisite beaches, English as a native language, the U.S. dollar as its currency, and British oversight—all appealing to visitors and investors. Even as the sun-hungry and the wealthy have begun to return, the Islanders are still waiting: for punishments to be doled out, for the return of self-rule, maybe even for a long-term economic plan.

The Cessna makes its way back to the air base on Provo, short for Providenciales, the main island where Misick once had two private jets on call. The plane glides by the mansion complex he put on the market in February 2010 for $15 million. The house, named Villa Belview, features Greek-style porticos, a cigar den, a screening room, and a glass-bottom pool. It hasn't sold.





"We ain't broke, we rich," former Turks and Caicos Premier Misick liked to say, according to his wife, LisaRaye McCoy



It seems like everything is for sale on Providenciales

Lucy Lee, a Floridian who has been here for 30 years, offers another name for the place: "Land of Incredible Failures."

In retrospect, Turks and Caicos was primed to rise and fall with the real estate excesses of the most recent Gilded Age. The cluster of islands is an offshore tax haven, though it has never enjoyed the prominence of Cayman or the British Virgin Islands. Unlike those islands, it was almost entirely undeveloped, despite being only 90 minutes from Miami. The local population, descendants of stranded African slaves, numbered just 10,000, and anyone determined to find an education or a job beyond fishing or local government had to leave.

That showed signs of changing in 1984, when Club Med arrived and paved a road from its new resort to the airport. Today, Club Med and the Sandals-owned Beaches resort remain the only major chains in a country that has no Hilton, no Marriott, no McDonald's. It also has nothing in the way of agriculture or manufacturing. What it does have, it has in abundance: some of the best beaches in the region, pristine and white-gold and turquoise.

The plan, if there was one, began and ended with luxury. The geography could offer the seclusion demanded by the ultra-high-end customer, and the islands lacked the restrictions on

TURKS AND CAICOS: PHOTOGRAPHS BY KEVIN COOLEY FOR BLOOMBERG BUSINESSWEEK (2); DOUGLAS AND ZETA-JONES: FRAZER HARRISON/GETTY IMAGES; MISICK: ARNOLD TURNER/WIREIMAGE/GETTY IMAGES

WorldMags

WorldMags

The Mandarin Oriental on Dellis Cay has been in receivership for a year and a half





Michael Douglas and Catherine Zeta-Jones at the Provo airport in 2007

foreign ownership of many of its neighbors. Turks and Caicos soon had better flight access than similarly positioned Anguilla and St. Barths as well. And for the first major wave of overseas investors, Turks and Caicos was a bargain. "Here you could get beachfront land for $350,000 an acre, compared with $2 million in Cayman," says Stan Hartling, a Canadian-born resort and condominium developer. "And there were no major players to knock you out of the marketplace."

The trick was getting financing. "The first time I had a FedEx package sent here, it went to Istanbul," says Mark Durliat, an American who is chief executive officer of the Grace Bay Club hotel and condos. Potential lenders would ask, " 'Turks what? How much equity do you have?' They would ask for three times what we said we had." Construction was fueled by brisk presales among affluent boomers, most of them from the northeastern U.S., and a crop of luxurious condo-hotels soon sprouted along Grace Bay beach in Provo. The private island resort market, with an eye toward the success Singaporean luxury barons Christina Ong and husband, Ong Beng Seng, had had with Parrot Cay, launched an arms race for celebrity anchor tenants and exotic amenities. Never mind the logistical challenges of building on far-flung cays with no infrastructure. As Andy Wimsatt, former managing director of the West Caicos project, put it: "The nail's imported, the hammer's imported, and often times the worker swinging the hammer is imported, too." The cost of building was high, but as long as the money kept flowing, no one cared. The population swelled to 36,000 with guest workers and expatriates from around the world. "You could fall down the stairs and fall into a pot of money," says local lawyer Timothy P. O'Sullivan.

It wasn't the first gold rush Turks and Caicos had seen; the outer islands are littered with the marks of previous centuries' failed exploits, and legitimate businesses have always co-existed with swindlers and despoilers. The Ritz-Carlton, which was to be built on West Caicos, is named after Molasses Reef, a Spanish shipwreck, which was plundered by rogues 30 years ago before archaeologists could get to it. Local lore has it that Parrot Cay's original name was Pirate Cay, before marketers renamed it.

For modern-day Turks and Caicos, the economic hangover was already setting in when the British alleged, in a May 2009 report from the Turks & Caicos Islands Commission of Inquiry, that there had been a "high probability of systemic corruption in government." The treasure in question: thousands of acres of prime public land, the islands' only natural resource, and millions of dollars spent on private jet travel, stylists, and sundry personal enrichment. The alleged rogues: deep-pocketed businessmen and Turks and Caicos' local elected government, chiefly Misick, its Premier.

Misick, 45, describes himself on his Facebook page as a "charismatic visionary," and few who know him dispute the first part. One former associate says he moved around with an intimidating bodyguard, and the British, charged with oversight of the islands, including defense, financial regulation, police, and the court system, stood by as Misick's flamboyant lifestyle became intertwined with the local economy.

Misick's nickname was Iron Mike. His stated dream was to make Turks and Caicos the Monte Carlo of the Caribbean. He had trained as a lawyer in England and, in Turks and Caicos, ran a property and financial-services firm. After rising through the Progressive National Party, or PNP, ranks to become Tourism, Transportation, and Communications Minister, he was narrowly elected Chief Minister, the highest elected office, in 2003. (In 2006 the Chief Minister title was changed to Premier.) He and his cabinet came to be known as "Mike and the boys."

In 2006, with the island economy booming, Misick married actress LisaRaye McCoy, a lithe, fiercely determined American who had worked as a model and hip-hop video star. "I had just wrote a list of the type of man that I wanted in my life," McCoy would later testify before the British commission. She "felt that God kind of sent him to take me away." Since McCoy was busy shooting a sitcom called *All of Us*, Misick flew her by private jet from Los Angeles two or three times a month, at a cost of $100,000 round-trip, according to her testimony at the

WorldMags

In 2002 free diver Tanya Streeter kicked off the good times with a world record dive



Commission of Inquiry hearings. They married at the Amanyara resort, McCoy in a Swarovski crystal-encrusted dress with a 30-foot train. "Fairy tales do come true," she told *Ebony*.

The couple lived in Villa Belview and planned another palace in Los Angeles. A Gulfstream III took McCoy on vacations to Africa and to visit her daughter in boarding school in Switzerland, according to her testimony. For years, McCoy has dressed exclusively in white, and she told the commission that she required a "First Lady" wardrobe complete with gloves and hats in the same color, by her own estimate spending as much as $200,000 a month. Never mind; Misick had an American Express Centurion Card. "He would always say constantly ... 'We ain't broke, we rich.' That was, you know, our little slogan around the house," McCoy testified. She said she assumed he'd made the money in his previous business ventures. McCoy also told the commission of Misick's generosity to constituents, handing out cash while campaigning—"not a lot, a $100 bill here and there." Former Deputy Premier Floyd Hall testified that he spent about $15,000 annually on the 200 mothers in his constituency, much of it on jewelry. The entire electorate was fewer than 7,000 people.

Like all modern fairy tales, this one had its own reality show, a pilot produced by Lifetime. It was going to be called *The Premier and I*. The vice-president for reality programming at Lifetime told *Variety* it would be "a voyeuristic look at the lifestyles of the rich and famous." It also had an ad campaign for the islands, for which Misick's tourism ministry paid McCoy $300,000 to star in an eight-day photo shoot, according to the commission. The ads ran in *W* and *Vanity Fair*. McCoy told *Bloomberg Businessweek* that the campaign boosted tourism by 40 percent, although a recent British-commissioned Tourism Working Group report put the annual net increase at less than 2.5 percent. Turks and Caicos spent more than twice the Caribbean average per tourist, according to the same report. Condé Nast has since sued the country for more than $1 million in unpaid bills.

In the spring of 2008, Misick was accused of raping a woman at the villa (the case was investigated by the FBI but no charges were filed), and in August, McCoy and Misick brought domestic violence charges against each other and announced their intention to divorce. In December seven members of Misick's PNP publicly turned on him, announcing that they'd tired of his "tabloid, D-list, Hollywood-style of leadership."

They had reason to distance themselves: The British governor had called for a Commission of Inquiry into possible corruption in the Misick administration. Its hearings, which began in January 2009, laid bare the commingling of PNP funds, public assets, and Misick and his inner circle's personal spending, and led to the naming of a special prosecutor, Helen Garlick, and a Civil Recovery team charged with clawing back as much loot as it could. The commission recommended a criminal investigation into "high probability of systemic corruption in government," naming Misick and four senior members of his cabinet.

A policy had long been in place to empower Belongers—the favored political status given to indigenous Turks Islanders—to purchase public "Crown land" at a deep discount. That policy, the Commission of Inquiry report suggested, had been abused by ministers and their families, who purchased adjacent tracts of land at a deep discount and then "flipped" them to developers at great profit. The Natural Resources Minister actually wrote a letter addressed to himself, approving his own purchase of Crown land, according to the Commission of Inquiry.

The British also demanded explanations for vaguely worded "loans" made to Misick or his brother; "finder's fees" for private land sales to developers who were currying his favor; undisclosed ownership interests in major projects; and "donations" to the PNP of as much as half a million dollars by developers. Of one $100,000 payment from a company called Caicos Construction to the PNP, the U.K. counsel demanded, "What is political about that, Mr. Misick? ... Here is some money to use for yourself. That is not a political donation. It is a gift possibly."

"You are obviously not a Caribbean politician," said Misick.

"I am still waiting to hear from a Caribbean politician, with respect, sir, what it is about $100,000 from a construction company that has a political angle to it when it is put into his wife's company so she can go and spend it in the USA," the lawyer replied. (PNP payments of hundreds of thousands of dollars had been made to McCoy's American stylist, according to the findings.) "Explain it to me again, please."

The Commission of Inquiry hearings devoted considerable time to the relationship between Misick and Slovakian developer Mario Hoffman, characterizing it in a way that Hoffman's representatives vigorously fought. The commission's report alleged that Hoffman gave a company controlled by Misick's brother Chal an undisclosed 50 percent share in Hoffman's grand-scale development on Salt Cay, which was in turn used as collateral for a $6 million loan to Misick. A Salt Cay homeowner who resisted selling her plot there testified before the commission that Hoffman had said he "owned" the government. Stefan Kral, CEO of Salt Cay Devco, Hoffman's company, told *Bloomberg Businessweek* that the company was fighting back in civil proceedings after Garlick filed a writ to halt the development. Chal referred requests for comment to Kral.

Misick resigned in March 2009, replaced by another PNP member, until the British dissolved the entire government and suspended the constitution in August. The governor, Gordon Wetherell, announced, "Our goal is to make a clean break from the mistakes of the past by establishing a durable path towards good governance, sound financial management, and sustainable development." It would be yet another new start.

Misick did not respond to repeated requests for an interview submitted to Karen Misick, operations and sales manager for his company, Prestigious Properties. (She is also his niece.) In Misick's resignation statement, he said he had "regrets and personal pain and agony" partly resulting from his "mistaken judgment." Later he told *The Times* of London that to create the Monte Carlo of the Caribbean, "You need First World infrastructure, First World accommodations, celebrities, businessmen. ... That is a policy direction. Is that corrupt? No." He has said several times that he dreams of leading the islands to independence from the British.

According to a recent British report, the economy

NEALE HAYNES/REX USA

WorldMags

WAREHOUSING AND DISTRIBUTION /// MANUFACTURING SUPPORT /// REVERSE LOGISTICS AND REPAIR /// SERVICE PARTS LOGISTICS
BUSINESS PROCESS IMPROVEMENT /// MATERIALS MANAGEMENT /// TRANSPORTATION MANAGEMENT /// SUPPLY CHAIN CONSULTING



WorldMags

doubled between 2002 and 2008, yet in that time public spending tripled and public-sector employment almost doubled. Even without its criminal problems, the country faces around $365 million in public-sector liabilities, and lawsuits over unpaid bills have piled up. All of this happened as prize Crown land was sold off to the politically connected at far below market rates. It seemed that the days of the pirates weren't in the past after all.

Misick told *The Times* of London, "I am a simple island boy who grew up here, was born here, and will always live here."

Two years after the Commission of Inquiry hearings, Turks Islanders aren't blaming Misick for their bleak future; they're blaming the British. At a forum the British set up to give Turks Islanders a say in the reorganization, a local woman named Linda Williams complained that the British "are saying to the world, 'This is a bunch of crooks.'" Misick himself called the British governor a "racist dictator" before the Turks' House of Assembly, before the House itself was dissolved, according to press reports. With cuts looming in the civil service and construction jobs long gone, as many as 10,000 people, almost a third of the population, are believed to have left the island since January 2009, according to two executives at local utilities. The only locally owned bank has been liquidated. A crime wave—robbery, arson, a small number of murders—has shocked locals. Canadian contractors are set to take over the police force.

"I suspect if you dug deeply enough and took a jaundiced enough view of it, you could probably throw these kinds of claims against half the population," says attorney Gordon Kerr, a financial-services commission member who worked on some of the deals being scrutinized and works for a law firm run by Misick's brother. "Do you sue someone whose kids got a scholarship because they were connected politically? How far do you go?" Overall, the expat-dominated business community expressed frustration that all business done on the island has been sullied before any charges of corruptions have been brought.

Misick's associates included Jamaican businessman David Smith, who had moved to Provo and been granted Belongership. The U.S. has charged him with fraud and money laundering in a $200 million Ponzi scheme in federal court in Florida. Smith pleaded not guilty. In January a PNP protocol officer became the first Turks Islander to be arrested in connection with the case. Garlick recently told the local *Turks & Caicos Sun* that money laundering forms a major part of the investigation.

The Independent newspaper in England is currently locked in litigation with Lord Michael A. Ashcroft, whose British Caribbean Bank is a major lender to developers on the island and where PNP and Misick accounts were held. At the center of the libel suit, on which a judgment is expected this week, are two reports in the paper that Ashcroft's bank funded Misick's lavish lifestyle with a $5 million loan. A spokesman for Ashcroft, a major donor to the British Conservative Party, told *Bloomberg Businessweek*: "Neither Lord Ashcroft nor any business with which he is or has ever been associated has extended a loan to fund Michael Misick's lavish lifestyle." A recent report on Ashcroft by the BBC's *Panorama* said his dealings in Turks and Caicos are a subject of Garlick's investigations. The spokesman said, "Nobody connected with Lord Ashcroft has any knowledge of it."

The British sent investigators to rewrite the constitution, recover millions lost in land deals, and bring indictments

The Civil Recovery team appointed by the British has so far attempted to regain what it says was lost revenue on the sale of a $48 million private island villa and a handful of Crown land sales, and recently asked the Supreme Court to allow it to terminate a development agreement for a Provo resort, Third Turtle Club & Spa, which it says was tainted by bribes to Misick and his deputy. This month the British came through as guarantors of a $260 million commercial loan to the islands—a Caribbean Troubled Asset Relief Program.

Jeff and Lucy Mott Lee are still waiting for the lights to go back on in Ambergris Cay so they can pilot their Cessna to their plot there. From the sky, all looks well on the island, with its dramatic 5,700-foot jet strip jutting into the water and the ultraluxurious residential community where Anne Hearst and Jay McInerney own a home. But water and power have been shut off since November, when the development went into receivership.

At least that project was mostly finished. The private island resort of Dellis Cay, near Provo, promised to be an eco-friendly haven, as imagined by star architects Zaha Hadid and Piero Lissoni. Catherine Zeta-Jones and Michael Douglas were going to build there, not far from a planned Mandarin Oriental hotel. But with the development in receivership for a year and a half, all that can be seen is a cluster of naked concrete hulks. In late January, 20 parties sued the developer, Cem Kinay, in a U.S. court, accusing him of "stealing" much of the $50 million they gave him for Dellis Cay villas. Kinay did not respond to a request for comment. He has denied the allegations to the *Turks and Caicos Free Press*.

The collapse of Lehman Brothers, the major backer for the Ritz-Carlton on West Caicos island, led to an abrupt halt in construction in October 2008. Hundreds of Chinese workers held their Israeli contractors hostage over a wage dispute, and diplomats were called in. Two years later the most action West Caicos has seen is the sloop of Haitian refugees that recently landed on its shores. They were promptly sent home.

The Tourism Working Group report questioned the sustainability of focusing exclusively on the high-end tourist. "There is a notion to have a broader mix of affluent and more middle-of-the-road—I don't want to say budget—tourism," says local director of tourism Ralph Higgs. "While the luxury market is more recession-proof, you need a certain amount of mass to make things happen." Although an airport expansion is under way, just in time for new direct flights on Continental and JetBlue from Boston and New York, the island lacks the capacity for large numbers of less-than-wealthy visitors.

For the foreseeable future, Turks and Caicos remains dependent on the same ultrarich who've paid little or no price for the past. For average Turks Islanders living with unemployment and massive public debt, the return of the moneyed is bittersweet. On the morning after New Year's, the private airport was the busiest in the world, its general manager told the local press, with 113 jets coming in and out. Donna Karan's, with its signature copper-colored trim, is always easy to single out from the pack.

"They were stacked on top of each other," says Jeff Lee of the Citations and Gulfstream Fives he spotted. "It was like a maze just to walk through." B

WorldMags



The Most. Fuel-Efficient. Midsize. Sedan. In. America.
What does that mean exactly?
It means the 41 city mpg 2011 Fusion Hybrid has a lot to say.
Seriously, just look at that claim, will you? It's quite the loaded statement.
Let's break it down.
First off, don't overlook the fact that it's a 2011. It's easy to do, but 2011 means it's new. Shiny and fresh, full of promise and possibilities.
Next – and this is a big one – it's the most fuel-efficient.
BEST
That means it has best-in-its-class mpg.
And how many can say they're the best in their category? Usually only one. And in this case, it's the Fusion Hybrid.
And Fusion is the most fuel-efficient in America, which is a pretty big place, with a lot of potential competition. Or not much competition at all, depending on how you're measuring it.
Either way, it's definitely good news for Ford, for Fusion and for its drivers.
Think about it –
who wouldn't love the Fusion Hybrid getting 41 city mpg?
Well, now that we think about it, the 2011 Camry Hybrid, for one.
Fusion beats it by a full 10 mpg in the city.
OUCH
OK, so sure, Camry probably isn't one of Fusion's biggest fans. But, since Fusion is a hybrid, let's hope we can find common ground in the fact that
its superior fuel economy
(sometimes it uses no gas at all!)
is better for the environment.
So, in the grand scheme of things, the 2011 Fusion Hybrid is doing some good for all of us. Even for the 2011 Camry Hybrid. You're welcome, Camry Hybrid.
So there you have it.
THE 2011 FUSION HYBRID
The most fuel-efficient midsize sedan in America.*
If you're thirsty for more fuel economy info, you can find more of it, plus other exciting Fusion news, at
ford.com.
*EPA-estimated 41 city/36 hwy/39 combined mpg. Actual mileage will vary. Midsize class per R. L. Polk & Co. vs. 2010/2011 competitors.
Ford
Drive one.

WorldMags



Give the gift of Bloomberg Businessweek.

Go to: businessweek.com/subs/gift

Outside the U.S. and Canada: www.businessweek-subscribe.com/gift

PRIVACY NOTICE
Occasionally, and subject to applicable laws, we may share your name, address, and e-mail address with other units within Bloomberg L.P., its subsidiaries, and its affiliates as well as to selected outside companies whose products or services we feel may be of interest to you. Many of our subscribers find these promotions valuable, whether they are shopping for new services or taking advantage of a special offer. Please be assured that we take your concerns about your privacy seriously, and we intend to take every reasonable effort to protect it. To that end, we have developed a comprehensive Customer Privacy Policy. If you'd like more information about our use of customer data, please review our Privacy Policy, located at: **www.businessweek.com/privacy.** Please note that this information is stored in a secure location in the U.S. and that access is limited to authorized persons.

If you would prefer not to have your data shared by Bloomberg Businessweek with either other units within Bloomberg L.P. or outside companies, please go to: **bwso.businessweek.com/r/bwo_o.asp**

If you have any questions or comments, or want to confirm the accuracy of your information you have provided, please call 1-800-635-1200 or write to: **Bloomberg Businessweek Customer Service P.O. Box 6203 Harlan, IA 51593-1703**

Bloomberg Businessweek publishes weekly, except when combined issues are published that count as two issues, and when an additional special issue may be published.

WorldMags

Go ahead, tie one on page 85

The Opera & Man Scarves & Rogue Oil Traders

Etc.



James Franco: Academy Awards co-host, swag target. page 80



The green monster: Cucumber, celery, spinach, romaine lettuce, kale, parsley, and more

Red, red slime: Beets, carrots, lemon, and ginger

The great off-white hope: Cashew nut milk with vanilla bean and cinnamon

Nothing Tastes as Good as Skinny Feels

How juice cleansing became the chicest get-thin-quick scheme

By Gillian Reagan

Photograph by Jamie Chung

TOP: X17ONLINE.COM

WorldMags

Etc. Cleansing

Zoe Sakoutis and Erica Huss Jones met in 2000, during the unfolding of Manhattan's Carrie Bradshaw decade. Both bartenders at the swank Hudson Hotel, they spent a lot of time hanging out with girlfriends, swilling frilly drinks, and trying to stay skinny. Perplexed by faddish diets (Atkins, South Beach) that allowed weight watchers to nosh while avoiding certain food groups (carbs, saturated fats), Sakoutis had an epiphany: to revitalize another faddish diet involving no solid food at all.

In 2006, Sakoutis began studying the effects of three-to-five-day, juice-only "cleanses" at the Ann Wigmore Natural Health Institute in Puerto Rico. After experiencing increased energy while losing body fat, she says she realized "this was an amazing thing that needed to be brought to the masses!" In January 2007, she and Huss Jones founded BluePrintCleanse and began selling organic juice drinks to friends. Today, the company employs 70 workers in its Long Island City kitchen and Manhattan headquarters. Assistants send support e-mails to fretful first-time cleansers while delivery men drop off juices—costing up to $85 per day—at customers' doorsteps. The company now has "several thousand" clients, including juicers in Canada and Hawaii, who cleanse anywhere from twice a year to once every six weeks.

BluePrint sits atop a burgeoning cleansetocracy that includes New York-based Organic Avenue and the Los Angeles-based duo iZO Cleanze and Cooler Cleanse. This form of power juicing has become the *au courant* how-to-get-thin-quick scheme of landed urbanites, with boutique cleanses taking up an increasing corner of the diet industry, recently valued at nearly $60 billion by Marketdata Enterprises. "Every company seems to have a line of juices these days, and since it's everywhere, everyone is doing a cleanse," says Dr. Lindsey Duncan, a Los Angeles-based nutritionist with three decades of experience. "It's the typical Western mentality: If two is good, then I'll take 22." Duncan should know. He sells his own line of cleansing juices, Genesis Today, in Wal-Marts and Walgreens across the country. Duncan suggests that his clients cleanse at the turn of every season. "Your energy is up, your mood is up, your mind is up," he says. "Just like a nice spring cleaning."

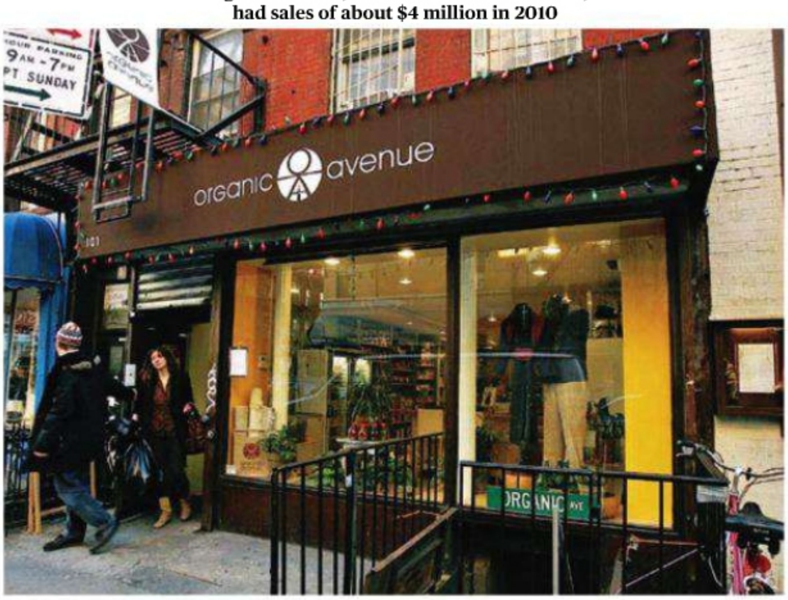
"We've got Wall Street and an incredible ... clientele that you'd think would have nothing to do with this!"

In addition to juices, cleansing companies are also selling an ideology. According to the BluePrint bible, after a three-day juice-only regimen, the body will "rid itself of old built-up matter and cleanse the blood." After five days, it will begin "the process of rebuilding and healing the immune system." Ten days? It will "take care of problems before they arise." The company says: "The only potentially severe side effect of this program is finally fitting into your 'skinny' jeans." Though that may depend on one's definition of severe. According to Dr. Michael D. Gershon, the chairman of Columbia University's department of anatomy and cell biology, there's "nothing but danger associated with" cleansing. "It is a practice to be condemned," he says.

Still, many appear willing to endure the potential danger of limiting their diet to 1,000 or so liquid calories per day. And while such luxe asceticism may seem like a shortsighted method of avoiding the gym, it does represent some sort of revolution in crash dieting. After decades of trendy weight-loss schemes, it was only a matter of time before haute fasting became fashionable. Cleansing was started in the 1940s by Stanley Burroughs, the godfather of the master cleanse—a 10-day detoxathon that requires converts to drink nothing but a concoction of water, cayenne pepper, maple syrup, and lemon juice. Newer companies offer riffs on Burroughs' concoction, building on the simple formula with juices made of kale, celery, apples, and other fruits and vegetables—all churned together into a *Ghostbusters*-like slime—and shipped to soccer moms' doorsteps. None have the definitive proof of science behind them.

BluePrint says its clients are about 80 percent female, typically aged between 26 and 42, educated, healthy, and wealthy enough to spend as much for a week of celery and beet juice as they might on a Marc Jacobs handbag. They're not exactly the masses, and that is the point. BluePrint has transformed home-delivered refrigerator packs of juice into an organic luxury item. While the biggest customers tend to be prospective brides, the fashion crowd, and power moms—"A *lot* of mommies," Huss Jones emphasizes—the cleansing trade's base remains its celebrity clientele. In 2008, Oprah completed a 21-day cleanse; Beyoncé cleansed to lose weight before shooting *Dreamgirls*; and perennial

Organic Avenue, which has seven locations, had sales of about $4 million in 2010



WorldMags

WorldMags

cougar Demi Moore admits to cleansing regularly with husband Ashton Kutcher.

Organic Avenue President Doug Evans says his business exploded in 2008 when Gwyneth Paltrow plugged the company on her lifestyle e-newsletter, *Goop*. Now, he says, Russell Simmons, Eva Mendes, and Naomi Watts are dedicated customers. While Organic Avenue sold about 700 $200 cleanse packages for all of 2006, last December "we sold 700 in one day," says Evans. The company, which has grown to six boutiques in Manhattan and one in Southampton, N.Y., now ships its liquid goods all across the country. Evans says his 2010 sales were around $4 million.

He and other juice companies can expect to face stiff competition from Pressed Juicery, a newly opened store in West Hollywood helmed by former TV producer Hayden Slater and erstwhile publicist Carly Brien. According to *Us Weekly*, Nicole Richie is already a happy customer. Perhaps more menacing is Cooler Cleanse, actress Salma Hayek's growing premium juice delivery service.

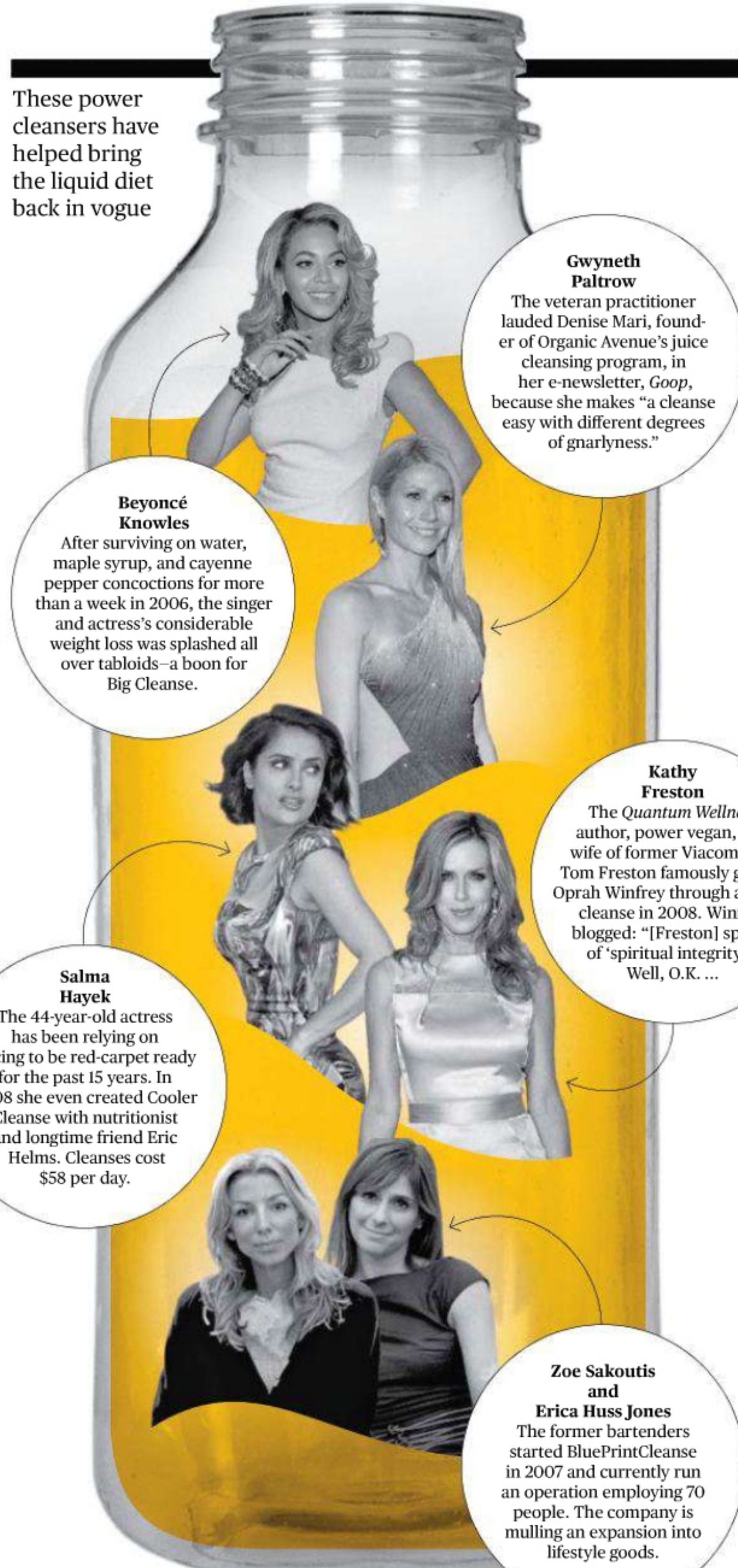
The fan base continues to expand outside Hollywood, too. Kathie Legg, who works in the social media department of the Democratic National Committee in Washington, D.C., began cleansing about a year and a half ago to combat the effects of her unhealthy diet. "I'm not a healthy eater," she concedes. "I eat pizza and burgers, and I was eating every meal out." The 110-pound Legg has cleansed "countless" times since then. She and her fiancé even signed up for BluePrint's Diamond wedding package in preparation for their July nuptials.

BluePrint has also made its way into the province of martinis and steaks. "We've got Wall Street and an incredible corporate clientele that you'd think would have nothing to do with this!" says Huss Jones. Max Haller, a 31-year-old investment analyst at Barclays in New York, has completed three BluePrint cleanses. "When I first did it, my buddies at work were like, 'What the hell are you doing?'" he says. "But a couple of them have done it since." Haller says he doesn't cleanse to shed weight from his 6'3", 220-pound frame, although he lost about 12 pounds during a recent five-day program, which, he says, "reset" him. When one of his friends asked him if he was going to gorge on steak and martinis after his last day of juicing, he realized, "I wasn't even interested."

With even bacon-obsessed men jumping on board, the boutique cleansing business is finally transcending its cult status—what Sakoutis calls "this underground place that it has been for so long." BluePrint now offers a line of raw, vegan meals and is testing sales of à la carte juice bottles in Whole Foods. Huss Jones says the company is considering morphing into its own über-healthy lifestyle brand. Perhaps BluePrint-sponsored Pilates retreats and a yoga pant line will be on the horizon. Or a BluePrintCleanse cruise. At least everyone would look good in a bikini. B

The Cleanserati

These power cleansers have helped bring the liquid diet back in vogue



OPPOSITE PAGE: SPENCER PLATT/GETTY IMAGES; THIS PAGE: KNOWLES: MICHAEL LOCCISANO/GETTY IMAGES; PALTROW: JON KOPALOFF/FILMMAGIC; HAYEK: FREDERICK M. BROWN/GETTY IMAGES; FRESTON: JASON KEMPIN/GETTY IMAGES

WorldMags



Janelle Monáe grabs some Body Shop swag before the Grammys



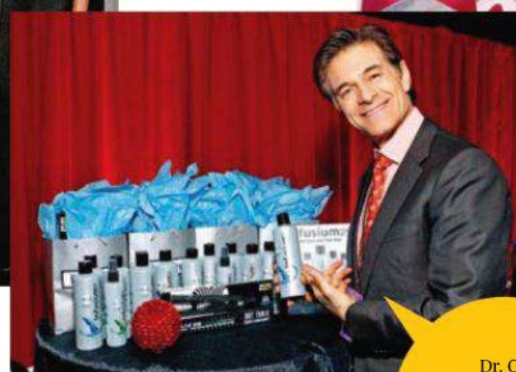
For Oscar losers: Sweet Endeavors dark chocolate, handpainted with white gold valued at $55



Grammy noms get an Epiphone John Lennon Revolution Casino guitar valued at $1,665



Artemis gift bags await celebrities at an Emmy lounge



Dr. Oz hits an H&M gifting suite in Manhattan last December

Super Swagonomics

The great tradition of peddling to celebrities is enjoying a renaissance. *By Michael White*

Every winter, Hollywood's biggest stars descend on film festivals and awards shows to promote their latest projects, exchange air kisses, and—most importantly—walk away with thousands of dollars in swag. At last month's Sundance Film Festival, James Franco, Jeremy Piven, and Elizabeth Olsen (the *other* other Olsen sister) were frequent guests of gifting suites. Items up for grabs ranged from tubes of Supergoop! sunscreen and Samsung Galaxy Tab handheld computers to Carrera sunglasses and Puma sneakers. Attendees were following in the footsteps of Paris Hilton, who once left a 2009 Sundance lounge with more than two dozen bags of free merchandise.

For many companies, giving away tons of free merchandise is worth the cost. RevitaLash scored a PR coup last month when Jennifer Love Hewitt proclaimed her devotion to the eyelash conditioner—telling a throng of paparazzi, "I love RevitaLash!"—while visiting a Golden Globes gifting suite. Hawking to movie stars has been particularly good to the small Ventura (Calif.) cosmetics company. In 2010 it spent $50,000 sponsoring and supplying film festivals and awards show gifting lounges. The company believes it generated press coverage equal to $2.4 million in advertising expenses.

The Oscars' "condolence bag" includes a $16,000 Indian Ocean vacation

While most companies keep their swagonomics private, the ritual of giving away freebies to celebrities has made a dramatic return amid the economic recovery. Gavin Keilly, whose GBK Productions organizes various gifting spaces during awards season, has planned a lounge where Oscar nominees can walk away with goodies ranging from $350 020608 Tears of Bleu designer jeans to a $40,000 African safari. "There has been a resurgence," says Karen Wood of Backstage Creations, a swag suite production company. "In the context of the economy, people are spending more. We're getting busier than we were in the past two years." According to Lash Fary of gifting pow-

MONAE: TIFFANY ROSE/WIREIMAGE; OZ: MARK VON HOLDEN/WIREIMAGE; GIFTS: CASEY RODGERS/WIREIMAGE; LOWE: NEILSON BARNARD/GETTY IMAGES; HINES: BARRY BRECHEISEN/GETTY IMAGES; BAGS: TODD OREN/GETTY IMAGES

WorldMags

WorldMags





Rob Lowe and Cheryl Hines (right) hit Sundance emporiums



For Sundance-goers: Carrera sunglasses valued at $120



A lounge attendant awaits the stars at the Sundance Film Festival



Asa Products' Mobo Cruiser bicycle, valued at $600, went to Grammy nominees



Oscar nominees can receive a trip to Africa's Zamani Zanzibar Kempinski resort

erhouse Distinctive Assets, this year's unofficial "condolence bag" delivered to Academy Awards runners-up the day after the show is worth $75,000. It features an Indian Ocean vacation valued at $16,000.

The goal, of course, is to create buzz. For many companies the potential boon of linking a celebrity to a product—especially in the Twitter Age—outweighs the losses or gaucheness. "The right product combined with the right celebrity and the right exposure, those three things together can create a pretty powerful marketing tool," says Michael Stone, co-founder of the Beanstalk Group, a marketing consultant. Says GBK's Keilly: "If we get one or two placements from it, it pays for itself."

Swag has also jump-started its own micro-industry. At Sundance, companies paid $7,000 to $10,000 merely to participate in a gifting suite, plus $30,000 for name sponsorship. Suite producers—a gifting oligopoly that includes Backstage Creations, Distinctive Assets, GBK, and Talent Resources—also pay up to $200,000 to rent space, arrange celebrity visits, and manage publicity.

Despite the gaudy values of gift bags, though, few celebrities redeem their travel certificates, traditionally the most expensive items. Other goods get passed off. Says Redfoo, of hip-hop group LMFAO: "Some of this stuff, I've got to be honest, I'm going to give to my friends. I don't need it." And even though they're famous, celebrities aren't immune from the IRS. Companies hand out 1099 reporting forms along with any gift worth more than $600. For some celebrities, the paperwork may bring back Pavlovian memories of Swaggate. In 2006 the official Oscar gift bag—valued at more than $100,000—set off calls from the IRS. (The Academy of Motion Picture Arts and Sciences took responsibility for taxes due on the swag—and discontinued the bags.) Meanwhile, Fary says, the actual value of the goods celebrities walk away with per event reaches only the low millions—particularly since so few redeem their vouchers.

"If we get one or two placements from it, it pays for itself," says one swag professional

Some gifting suites also allow celebrities to limit their tax liability by offering space to nonprofit groups. "It's a win-win-win situation," Keilly explains. "The celebrities win because they're getting a $50,000 or $60,000 gift bag. The charities win, and lastly, I win, because I'm making a living doing this." **B**

WorldMags

WorldMags



SAS software's global headquarters in Cary, N.C., has 21 buildings on 350 developed acres

Analyze This

Software proves the benefits of analytics

In 2010 the world's largest privately held software company, SAS, had an employee turnover rate of 2.6 percent—pretty impressive, given that the info-tech industry average was 22 percent. It doesn't take a data-mining program to figure out why: It's the perks. The Cary (N.C.) campus, home to about 4,700 of the analytics company's 11,000 workers, is benefit-crazed. SAS has everything from a health center, which 75 percent of employees use for their primary care, to a campus hotel—with its own art collection. Even nearby Prestonwood Country Club, owned by SAS Chief Executive Officer Jim Goodnight, gives employees a discount. Yet there's no perk like job security. Since it was founded in 1976, the company has never had a single layoff. —*Jessica Flint*

The Perks

1. Solarium
Communal meeting spaces, such as the palm court in the research-and-development building's glass atrium, abound throughout the campus.

2. Tennis
Outdoor recreation facilities include tennis courts, running tracks and trails, a baseball diamond, and a volleyball court. Intramurals are a popular activity.

3. Fitness Center
A 66,000-square-foot recreation hub occupies four buildings in the middle of campus. It's free for employees and includes a men's and women's locker room.

4. Billiard Hall
Pool tables are housed within the rec center, which also has courts for basketball and racquetball.

5. Pool
Employees are encouraged to use the pool, along with the other fitness facilities, throughout the day.

6. Child Care
A subsidized infant day-care center and a Montessori preschool are available for workers with children.

7. Salon
Employees can get their hair coifed—everything from basic trims to highlights.



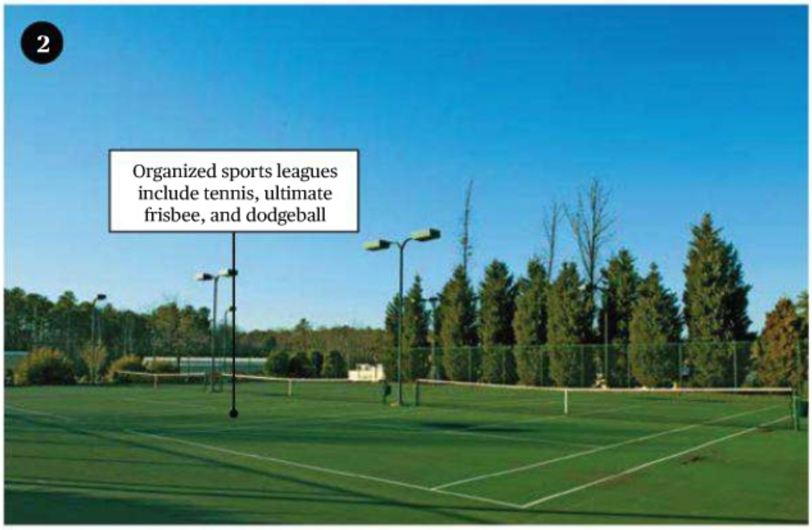
Every floor of every campus building has a pantry with free snacks such as fruit, trail mix, and M&Ms

Atriums are used for events such as company-wide toasts

More Perks: Three cafeterias ▶ Subsidized massages ▶ Classes on managing finances and stress ▶ Dry cleaning ▶ Nail salon ▶ Shipping center ▶ Car detailing

WorldMags

WorldMags



Organized sports leagues include tennis, ultimate frisbee, and dodgeball

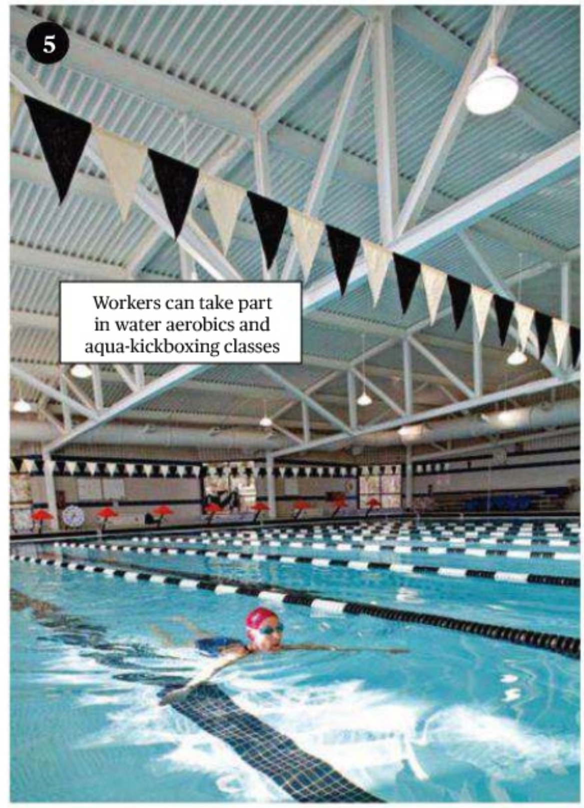


An incentive program rewards employees for going to the gym

The rec center offers group classes in body sculpting, yoga, tai chi, and more



CEO's motto: Treat employees as if they make a difference to the company and they will



Workers can take part in water aerobics and aqua-kickboxing classes



The child-care center can accommodate more than 600 kids



The building housing the salon also offers jewelry repair and skin-care services

PHOTOGRAPHS BY SEAN BUSHER FOR BLOOMBERG BUSINESSWEEK

▶ **Bottled-water delivery** ▶ **Elder-care and adoption assistance** ▶ **Banking** ▶ **Orthotics store** ▶ **Book fairs** ▶ **Racquet stringing** ▶ **Craft sales** ▶ **Farmers markets**

WorldMags

The Phenom Of the Opera

At first, Lee needed to supplement his income by doing tax returns for 12 private clients; he's whittled them down to five



Colin Lee ditched a career in spreadsheets to focus on sheet music. *By Warwick Thompson*

Ten years ago, Colin Lee applied to be a financial controller at London's Royal Opera House. While the accountant didn't get the job, he was recently hired by that same institution—this time to play the role of Tonio in Donizetti's *La Fille du Régiment*. The former auditor is now one of the few tenors in the world able to deliver the nine top C's that the role demands.

As a boy, Lee studied at South Africa's Drakensberg Boys' Choir School, but after graduating from college he decided to get a "proper job." In 1990 he joined the auditing department at Ernst & Young in Cape Town. Three years later he was transferred to London, where after 15 months he took a job as a finance manager at Canada Life, an insurance and financial management company.

Yet Lee, now 41, hadn't outgrown his boyhood fixation. In London he began taking voice lessons and eventually hired an opera coach. As the lessons continued, he says he began to wonder, "Could I make this a career?" In 2000 his coach helped him score a job for the singing circuit's equivalent of the minor leagues: a three-month gig performing on Cunard cruise ships. To the shock of friends and colleagues, Lee promptly resigned from Canada Life. "People said I was brave," he says. "I wasn't. I just got to a point where I had to go."

While he had set aside enough money to live for 9 to 12 months, Lee's first few years as a fledgling singer were dicey. He earned less than $10,000 in fees during 2000 and approximately $30,000 in 2001. He even did tax returns for a dozen clients to stay afloat. However, a part in the D'Oyly Carte Opera Company's staging of *The Mikado* in London helped him gain entrance into the English National Opera Young Singers Programme. Soon, the *bel canto* roles began to pour in.

While Lee won't reveal his current earnings, he says he recently matched the income he made while in accounting. Meanwhile, he's learning how to manage in an expensive profession. Lee spends 30 percent of his earnings on travel, coaching, and administrative costs. "I'm earning at least what I need to get by," he says. "I wouldn't be a good accountant if I wasn't." **B**

Lee, a professional singer since 2000, now has 35 operatic roles in his repertoire



SINGING FOR HIS SUPPER

$3,200
Annual cost of Lee's voice lessons, vocal coaching, and accompanists

$30,000
Gross fees in 2001; in 2000, Lee earned less than $10,000

20-30
The number of hours each week that Lee spends working on his singing

1
Number of impossibly difficult opera directors with whom Lee has worked

DATA: COLIN LEE

FROM TOP: PHOTOGRAPH BY EMMANUEL FRADIN FOR BLOOMBERG BUSINESSWEEK; BRAND X PICTURES/GETTY IMAGES

WorldMags

Etc. One True Thing



The Office Dude Sweater

A versatile cardigan to keep desk-side for when your outfit needs a lift. *By Abby Perlman*

The Want: A men's cardigan to replace the chunky shawl-collar pullover you've been sporting all winter. It must class up any outfit, combat the air conditioner, and look sharp hanging from the back of your ergo chair. Bonus points if women can throw it on for a boyfriend-sweater look.

The Get: Cardigan by Lynne Hiriak's Sebastian Tipped sweater ($198 at cardigannewyork.com). This 100 percent merino wool staple has endless utility. Pair it with a dress shirt and slacks or T-shirt and jeans. No Mr. Rogers vibe here: The collegiate contrast piping makes it smarter than a no-frills layering piece. B

MARF ALERT!

Man scarves are coming this spring. Man up, no matter who you are.



The Woodsman

This preppy–and patriotic–Barneys number works bestwith a V-neck sweater and denim. *$140 at barneys.com*



The Natty Professor

The scholarly splendor of this Steven Alan color-blocked pastel scarf will enhance any sports jacket. *$98 at stevenalan.com*



The Dude

This John Varvatos Dot Tassel scarf, paired with a leather jacket, will get you ready to hit the town after work. *$125 at johnvarvatos.com*



The Dandy

The pops of color in this Thom Browne striped scarf will stand out against your cubemates' fluorescent silk ties. *$200 at barneys.com*



Blend it like Beckham

SWEATER: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; BECKHAM: VENTURELLI/WIREIMAGE

WorldMags

NYMEX traders turned to oil after getting busted manipulating the potato market



Mercantiles Gone Wild

Hookers, Cristal, and the rise and fall of the New York Mercantile Exchange. *By Bryant Urstadt*

Anyone who accuses New York Mercantile Exchange traders of being greedy and lawless anarchists who blow up markets obviously was not working the floor in 1978. In that year a sign at the entrance decreed: Please check your guns at the desk. "A gunshot never went off on the floor," claims John Tafaro, a trader at the time. "That's where we drew the line." He says traders were pretty dutiful about checking their guns, too.

The rest of the rules, though, they ignored, skirted, or subverted, sometimes with brazen crudity, sometimes through deft manipulation of the law—at least according to Leah McGrath Goodman's *The Asylum: The Renegades Who Hijacked the World's Oil Market*. "Any customer who traded there was molested, if not raped," says one ex-regulator with the U.S. Commodity Futures Trading Commission, speaking metaphorically, one hopes. "As far as we could see, the NYMEX traders did nothing but run scams."

They weren't always oil traders. They only stumbled upon oil futures after screwing up Maine potato futures. A whole industry had been built around predicting the Maine potato harvest, and—more importantly—trying to manipulate it. However, the market was closed by regulators in 1976, after defaults on deliveries of more than 50 million pounds of potatoes.

Casting about for something else to trade, then-Chairman Michel Marks tried to boost futures in boneless beef and plywood. After that didn't work, in 1978, he introduced heating oil futures. The market proved a gusher that led to 30 years of good times. Booming with the oil scares of the late '70s and early '80s, heating oil futures begat natural gas futures and became a huge market revolving around the price of West Texas Intermediate Crude, now the benchmark for a barrel of oil.

The years trading potatoes help explain why the NYMEX was able to trade oil for so long without worrying about meaningful oversight. Formed to offer hedges for farmers, the futures exchanges are under the purview of the same people who produce the omnibus farm bills: the House Agriculture Commit-

i

The Asylum: The Renegades Who Hijacked the World's Oil Market

By Leah McGrath Goodman
MORROW
398pp, $27.99

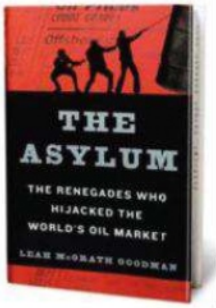


ILLUSTRATION BY JAMES DAWE

WorldMags

tee, which also runs the regulator in the business, the CFTC. In Goodman's account, the CFTC issued more exemptions than rules and, in any case, only enforced the latter gingerly. The first big exemption, allowing large trades for a financial participant, went to Goldman Sachs in 1991. Others soon piled in.

The NYMEX traders succeeded in spite of themselves. They booted their most able chairman, Marks, soon after he opened the oil market. In the ensuing years, traders and their clients rode the frenzy in oil right up to and over the precipice as speculative money, freed by exemptions, flooded in. When Congress held an inquiry into the runup in pricing, they were solemnly warned by then-NYMEX President James Newsome, a former head of the CFTC, about the dangers of "substituting the judgment of Congress for the judgment of trained financial investment professionals." Congress deferred to Newsome, who had majored in livestock production in college.

Books about trained investment professionals have their own regulations. One is that they must include some minimum number of scenes involving hookers, strippers, drugs, and parties. Here *The Asylum* is in full compliance. As the traders got rich, they indulged in the kinds of tastes developed in a room with no windows, full of men screaming at each other. Call girls, Goodman writes, were flown in on private jets from Brazil or deployed at parties in "canned hunts." At one particularly good party at the Hard Rock Hotel in Las Vegas, traders drank enough Cristal champagne that the managers were persuaded to move Jon Bon Jovi to another table—likely the social apex of the entire oil trading profession.

If it's any consolation to that cross-section of readers both outraged by Wall Street and willing to read long books about its culture, the NYMEX traders traded themselves into oblivion. They so loved their crude world that they refused to adapt to the computerization of the markets. That was the last of the bad decisions. In 2006 the NYMEX went public, earning the seat owners millions and the traders who rented their spots absolutely nothing.

There was no longer any point in waving chits of paper and wearing funny-colored jackets. Purchased by the Chicago Mercantile Exchange Group in 2008, the NYMEX has become a brand name for certain futures and options, such as the price of a barrel of crude. The oil pit remains, but only a few traders show up, executing their orders on laptops. It's odd, but one feels nostalgic for the amoral furor of the pits. The traders were undereducated, drug-taking greedheads who would "rip your heart out for a penny," as one reminisces. But at least they were human. **B**

The Oil Book Economy

The petro-lit genre is publishing's latest gusher. Here are some of the most notable tomes, as arranged by subgenre. —*Spencer Bailey*

Insider Rant

Why We Hate the Oil Companies
by John Hofmeister
The author, a former president of Shell who now runs the nonprofit Citizens for Affordable Energy, explains why everyone—from politicians to environmentalists—is wrong about oil. And how they use the topic to advance their agendas.



The Mogul Tell-All

The King of Oil by Daniel Ammann
Marc Rich, the tight-lipped billionaire oil trader, who infamously received a pardon from Bill Clinton, provided Swiss journalist Ammann with 30-plus hours of personal interviews and privileged access to associates.



Peak Production Primers

When Oil Peaked
by Kenneth Deffeyes
Written by a Princeton geoscience professor and former Shell geologist, this book updates the peak oil debate. Deffeyes draws from historical data and research to make the argument that oil production peaked for the final time in 2005.

Petro State Tomes

Oil by Tom Bower
A global exploration of the modern petroleum industry, Bower's book is the magnum opus of contemporary oil lit. It follows the race for reserves in the depths of the sea—and in the backyards of the world's most mercurial leaders, such as Vladimir Putin and Hugo Chávez.





BP Takedowns

Drowning in Oil
by Loren C. Steffy
The *Houston Chronicle* columnist's book—one of the first reprisals of the Deepwater Horizon catastrophe—shows how a corporate culture of cost-cutting led to the largest environmental disaster in U.S. history.



Blame Canada!

Tar Sands by Andrew Nikiforuk
Taking a critical look at the tar sands of Canada—the No. 1 supplier of oil to the U.S.—Nikiforuk's book investigates how oil companies have poured roughly $200 billion into the region despite giving little forethought to economic, social, and environmental implications.



OPPOSITE PAGE: GETTY (12); CORBIS (5); AP IMAGES (3); THIS PAGE: RICH: GUIDO ROEOESLI/AFP/GETTY IMAGES; WHALE: FRANK GREENAWAY/GETTY IMAGES; HAYWARD: RUPERT HARTLEY/BLOOMBERG; CHAVEZ: MIGUEL GUTIERREZ/AFP/GETTY IMAGES; SOUTH PARK: COMEDY CENTRAL/EVERETT COLLECTION

Bloomberg Businessweek (USPS 080 900) February 21 – February 27, 2011 (ISSN 0007-7135) T Issue no. 4217. Published weekly, except for a double issue in August and one in December, by Bloomberg L.P. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Executive, Editorial, Circulation, and Advertising Offices: Bloomberg Businessweek, 731 Lexington Avenue, New York, NY 10022. **Postmaster:** Send address changes to Bloomberg Businessweek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 41989020. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com. QST#1008327064. Registered for GST as Bloomberg L.P. GST #12829 9898 RT0001. Copyright 2011 Bloomberg L.P. All rights reserved. Title registered in the U.S. Patent Office. Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com. Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm. Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com. Custom Reprints: For customized bulk reprints of Bloomberg Businessweek articles, contact The YGS Group at 800-360-5549 or email: businessweekreprints@theYGSgroup.com PRINTED IN THE U.S.A.

Please Recycle This Magazine
FSC MIX Paper FSC® C101537

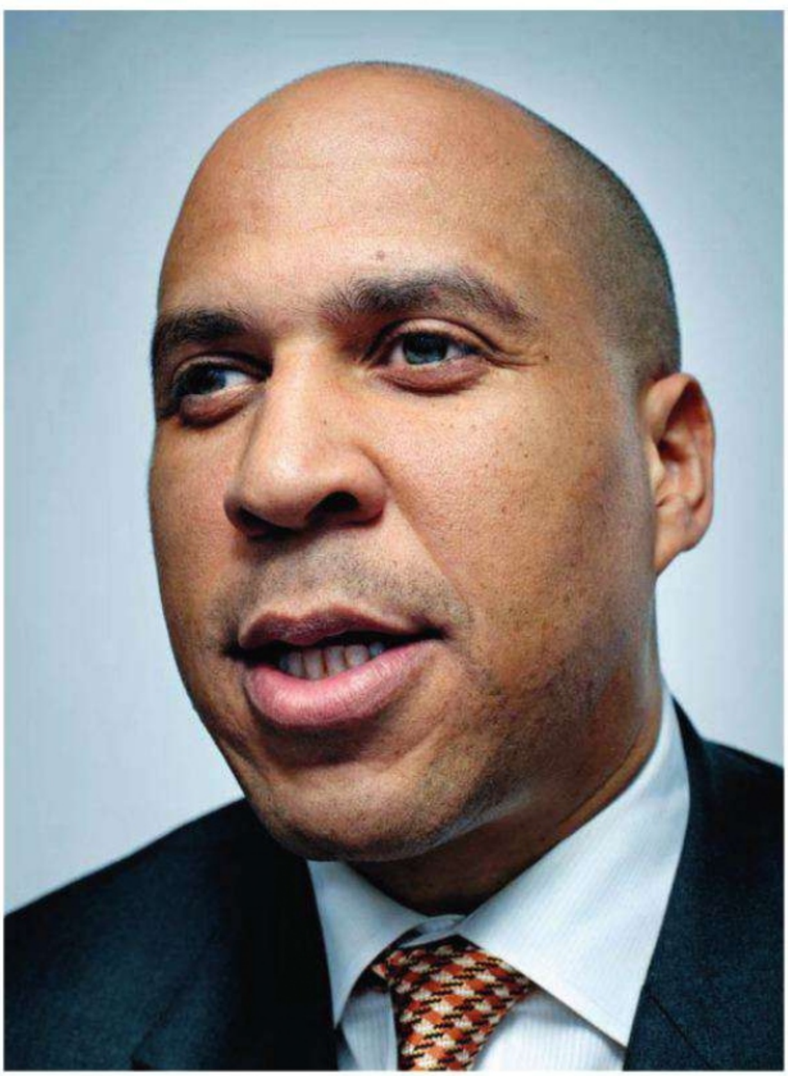
WorldMags

Etc. Hard Choices

Cory Booker

"The most painful decision for me was cutting 164 police officers right before Christmas. It was like I'd lost a bodily organ"

The mayor of Newark, N.J., on fighting crime while cutting the police force, and learning how to make tough calls as his approval rating drops



I came into office in 2006 with a lot of national attention. Newark's government was running a structural budget deficit of more than $100 million, and we had to dial that down immediately. The No. 1 issue was crime: That year, 435 people had been shot. We needed to beef up the police force.

At first, I thought the best strategy was to keep my head down and get to work. Then we realized that appearances on Bill Maher or Stephen Colbert brought buzz and made it easier to get meetings. I spent 25 to 35 percent of my time fundraising, and we raised $100 million for initiatives like crime-fighting technology, a wireless network, and parks expansion. That's before Mark Zuckerberg pledged $100 million to improve Newark schools. Oprah and Jon Bon Jovi helped us get more affordable housing. As a result of all this, we've seen a significant reduction in crime.

The hard change was Governor Chris Christie's election in November 2009. He lowered state aid. There's not a Newark city department that hasn't been cut deep into the bone. The most painful decision for me was cutting 164 police officers right before Christmas. It was like I'd lost a bodily organ. These were young men and women that I had recruited, that I had looked in the eye and said, "Our city needs you." After double-digit decreases [in previous years], shootings were up last year. Now we're looking at options like shared regional policing.

Last year was the most difficult of my career. I've gone from an 80 percent approval rating to somewhere in the 50s. I love this job, but we ask a lot from people in public life. I can't go out to dinner without worrying about who will pick up the tab. I was buying a shirt in New York City, and a woman got in my face to ask why I wasn't buying it in New Jersey. At 41, I realize I need to develop a personal life because I would like to have a family.

I've become more data-driven in making decisions, rather than coloring them with my passion. But you still have to think outside the box. You can't surrender to the options before you. There's always another way. B —*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

WorldMags

WorldMags



Today, Union Pacific coordinates the global reach of ocean carriers with the economy of our vast rail network plus the flexibility of truck transit. So, even if you don't have rail service at your door, we can still give you unmatched, door-to-door service. Find out more at UnionPacific.com or call (800) 877-0513.

Wherever you find business, you'll find us. UNION PACIFIC **BUILDING AMERICA®**

WorldMags



When a patron claimed to take a bad fall outside the entrance of a major retail establishment, the manager first went to her aid, and then came to us. Risk management planning had ensured there were anti-slip mats at the entrance and a surveillance camera, which captured the staged accident. The fraudulent claim was then denied and referred to the local authorities, protecting the customer from unwarranted losses and potential litigation. Whether it's responding quickly, keeping you informed, or helping to mitigate potential losses, our general liability experts are committed to helping you protect your business. That's our policy. For more information, contact your broker or agent or visit libertymutualgroup.com/gl.

Liberty Mutual.

LIABILITY | COMMERCIAL AUTO
PROPERTY | WORKERS COMPENSATION

Responsibility. What's your policy?®

WorldMags